

THE
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THE NATURE OF SMALL INDUSTRIES A SURVEY OF THE ECONOMIC INTERPRETATION IN JAPAN

By TOKUTARO YAMANAKA

Professor of Economic Policy and Labour Problems

I. *Why the problem of small industries is so much discussed in Japan?*

a

Even in highly industrialized countries, small or medium sized plants or firms are an important numerical proportion of the whole industrial organization. From time to time their position or fate has come to attract economic, social and political attention. As regards Japan the situation is deeply different. Small scale industries have a specially important place and are a characteristic of the economic structure. Many nations, especially in eastern under-developed areas, look to her guidance in order to bring up their native small industries.

Japan has grown during the last three quarters of a century from an undeveloped Asian country to an industrialized one. This transition means that modern capitalistic enterprise generally dominates the whole economic life while old and smaller productive units fade away under the competitive impact of capitalism. This was not true in Japan. The industrial revolution of the country left capitalist enterprise firms and the traditional small plants side by side. The reason I have given in another article.¹

¹ See my article, "Japanese Small Industries during the Industrial Revolution", The Annals of the Hitotsubashi Academy, Vol. II, No. 1, Oct., 1951.

In the 1930's when Japan was already an industrialized country, her export expanded remarkably. Most of these exported goods were manufactured by small plants. Moreover, when a further development of industrialization was reached stage in which producers' goods dominated output, a stage which is ordinarily marked by the growth of large plants, small plants continued to increase even in producers' goods industries.

Such development of small industries did not always involve healthy industrial progress but often they meant cut-throat competition, social dumping, inferior quality production, exploitation by trading capital and parent plants, etc. Despite these evils small plants continued to grow side by side with monopolistic large enterprises.

Small scale industries thus represent a large part of the industries not only in the number of plants but also in gainfully occupied industrial population. As these small industries form, with peasant farming, the biggest market for the employment of the labouring population, they evidently have an importance worthy of special attention.²

b

Thus for Japan the problem of small-scale industries is not of recent date. But it was after World War I that discussions about small industries from a political, social and economic viewpoint ensued. Since then the problem developed with the changing of the Japanese economy. At first it was thought that small industries, remnants of by-gone days, would pass away and be supplanted by modernly equipped industries, leaving only exceptional cases such as arts and crafts, etc. Some thought that smaller business could thrive where conditions of supply or demand were irregular, small, and local, where initiative and the flexibility of a manager could attain better results than large concerns. Some emphasized, on the contrary, that pressure of population cannot but give rise to industries which solely depend for existence to cheap labour. These early studies are either mechanical interpretation simply borrowed from the German Historical school or undue stress was laid on Japanese peculiarities, moreover they were a way of thought which may be said an analysis of the small scale industries, isolating

² As for 1930, the following figures were obtained by more or less complicated procedure. For more recent figures see those of 1951 by the Government Statistical Office, but the latter cannot be compared with the former as statistical methods are different.

Distribution of industrial workers by size of plants classified by the number of employees			
1930		1951	
Less than 5 employees	55.2 %	Less than 5 employees	12.51 %
5~29 "	11.9 %	5~29 "	30.81 %
30~99 "	8.3 %	30~99 "	17.61 %
100~499 "	10.8 %	100~199 "	7.30 %
500~999 "	4.7 %	Over 200 "	31.77 %
Over 1000 "	6.0 %		
Government works	3.3 %		

them from the rest of the economic phenomena.³

Since the world depression of 1930, small-scale industries have experienced several ups and downs and added new problems or renewed old ones; that is to say, the expansion, under cut-throat competition, of small export industries during the 30's; the creation of small machine-producing industries utilized and exploited as branch plants by leading firms during the late 30's; coerced stoppage or change of production of numerous small industries which produced export goods, consumers' goods, other than for war purpose at the outbreak of the World War II; destruction of plants, by bombing at the later stages of the War; the revival of small business, something like Phoenix appearing out of ash of War destruction, during the postwar inflation period; keen pressure of deflation since the so-called Dodge plan of 1949 which struck harder small firms; rapid ups and downs and everlasting financial difficulties since Korean War.

These changes in small plants soon showed the insufficiency of the above interpretations. Some new theory seems to be called for. One thing was clear. Originally small industries were considered as "Kleinbetrieb" by German economists at the end of last century. They gave the name to handicrafts, domestic industries or small independent producers. These were to be supplanted by the factory system of production, according to the stage theory of industry. But this classical conception of small industries is no more applicable to present industrial facts. This stimulated various studies of small industries in Japan which studies, though showing a wide difference of views, seem to have arrived at some general agreement as to essential points. These points consist of the following four.

As above stated, originally the problem was that of small businesses or producers, but at present it is of small and medium scale industries.⁴ This is the first point. It comprises a large part of factories. Therefore the term is to-day used in a wider and different sense than the classical meaning. In Japan this different meaning is clarified in the word itself. Instead of "small industries", the word "small-medium" or correctly speaking "medium-small" industries is in common use. Until about the end of World War I we met the term "small industries" ordinarily, and even "medium-large industries" on some occasions. Thus especially in our case the problem is that of a group of industries which embody small and medium enterprises as distinct from large ones. In other words, it is a group of industries from handicrafts to more or less modernly organized factories.

³ As to these various points of view, a more minute survey is necessary. I have done this in my work, "Nature and Development of Small Industries—An inquiry on the structural contradiction of the national economy", Tokyo, 1948. (*in Japanese*).

⁴ In Japanese the common use of the term is "medium-small" industries, while "small" industries define a more narrow sphere of facts. But, in this article, for the sake of simpleness of expression, "small" industries is used in order to represent the special meaning of Japanese "medium-small" industries.

In the second place, as "Kleinbetrieb" was conceived first in Germany, it was the result of the decline of small producers in handicrafts or putting-out system. The problem was treated as a social or labour question. The social position of these petty producers was similar to that of workers. The difference compared with modern factory workers was that they were "dispersed" wage earners. Or, the small industries at that time were discerned from factories or large enterprises which were driving them to decline by competitive force. Thus, originally small industries did not include factories. The main line of the study of small industries in Germany such as conducted by Paul Arndt was "Heimarbeit". Of course, the problem of present small industries includes labour and the social problem. For example, in the case of Japan, small industries can never be discussed without alluding to the fundamental tie with Japanese overpopulation. That is to say, her overcrowded working population provides the basis upon which small industries depend. So it can not be gainsaid that small industries are yet now social or labour question. However, today's small industries do not remain in this traditional place. Small industries comprise nowadays not only the remnant of the old industrial system but also industrial units which take the form of the factory system. Contrary to typical handicrafts or domestic work, they use machines driven by motor power. They employ not a small number of wage earners. It is now a problem of factories as well as labour. In other words, it is an economic, industrial, managerial and social problem.

Thirdly, originally small industries were supposed to be destined to collapse under the competitive pressure of capitalist production. This view has long been maintained by many. The opinion which Fernand Maurette of I L O published after a research trip to Japan some twenty years ago may be considered an example. In his report he foresaw the decline of Japanese small industries. But this proved not to be the case. Traditional or new small industries survived through economic fluctuations even after the first World War. Though their existence has been always uncertain, they have come through even equipped with more or less modern productive apparatus. Moreover, new branches of small industries other than the traditional ones have grown up in textiles, chemicals, woodworking, electro-engineering, machine-making, etc. In these branches their conditions have always been unstable and sometimes illogical; nevertheless they have continued to exist. This fact means that the theory of small industries should be that of their continued existence rather than their fading away under the impact of the capitalist system.

Fourthly as regards Japan, they demand an explanation why they are so numerous. In Japan, it is now thought generally that these are the essential points to be answered necessary in regard to the problems of small industries.

II. *Some Theories in Japan concerning Small industries*

As shown in another article it was a singular feature of her industrial revolution that Japan passed the period without the problem of small industries arising. When, for the first time during the prolonged depression following World War I, the problem became the subject of wide public interest, Japan has grown as a capitalist industrial nation with comparatively high monopolistic capital. Since then many studies have been made on this problem. In the course of these studies, in the late 1930's and during the period after World War I, there have been two instances of remarkable progress. Sample of publication during the later 1930's is prof. Teijiro Uyeda and associates' "Small Export Industries in Japan", 1937 published by I P R. As regards the opinions published until the end of World War II, I have reviewed them in my above cited work. In this article, attention will be paid mainly to see later studies added since the World War II ended.

Attention to the problem of small industries from the social and economic viewpoint has not been as keen in Europe and America as in our country. However, after the 1930's more attention seems to be paid to this problem among Western Nations. Perhaps, Kaplan, *Small Business: Its Place and Problems*, 1948, may be taken to represent the trend in U. S. A., and J. Steindl, *Small and Big Business, Economic problem of the size of firms*, 1947, the trend in England.⁵ Compared with these recent Western works our methods or chief interest has evident characteristics. It is not an easy task to introduce here the full results or trends of various works in our country.⁶ But it may be possible to classify them roughly in the following way, according to the way used in order to see the nature of small industries.

a

The first view tries to explain small industries by their conditions of existence. Among them one lays stress on the capacity of the entrepreneur. What divides small industries from big ones depends on the managing or

⁵ These American or European books are studied and analysed in : Prof. G. Suyematsu (ed.) "On Small Industries in Foreign Countries", Tokyo, 1953 (*in Japanese*). This is one of the reports of the research committee on small industries over which I preside, composed of 16 members, mostly university professors, which has been working these 6 years.

Compared with these foreign studies, Japanese studies have something left untouched which cannot be dispensed with. A comparison of added value according to size of firms in the whole industry may be one example. In Japan it has been impossible to conduct such a statistical research on industry as a whole, because no wholesale production census has been carried out until 1950.

⁶ About recent views upon small industries see the forthcoming book, one of the reports of the research committee above cited: Prof. K. Fujita and Prof. T. Ito (ed.), "The Nature of Small Industries", Tokyo, (*in Japanese*). Our committee has already published several reports *in Japanese*. I have the intention to publish in English a summary covering all these reports if the publication becomes possible financially for the committee.

administrative ability of the person who leads the business. If this ability is limited his firm can not grow whatever favourable conditions may otherwise exist. Among others belonging to this first type of view, the most important may be those who insist on the theory of optimum size. When the demand for a product is small, local or irregular, or when raw material, labour force necessary for the industry are supplied in small or irregular quantity or in limited or more or less immovable form the optimum size of industry should be smaller. That is to say in these cases smaller industries can favourably compete with bigger ones.

This conception leaves of course many questions to be answered. Various factors as regards optimum size in theory are apt to change in practice while a new combination of factors will tend to make the optimum size bigger as shown in many cases of rationalization. Moreover, this theory does not touch the difference of numerical importance of the small-industry population, for example the difference between Japan and U. S. A. In other words, this theory does not take account of the condition which influences the above mentioned conditions for optimum size.

b

A second view concerning small industries insists on the pressure of overpopulation. When the phenomena of overpopulation exist, labourers endeavour to obtain work at any cost. This is the chief source which keeps up small industries as well as poor peasant farming. This is also the source of cheap labour in under-developed countries. As in the case of Japanese export industries, a cheap and numerous labour force may enable small industries to beat Western competing industries in world markets.

Taking the case of Japan, the connection between small industries and over-population cannot be denied. The pressure of population influences industry as a whole. Cheap labour is the characteristic of Japanese industry big or small. Among this general cheap labour, labour in small industries is in fact specially cheap. Though the "cheap labour" is used often in different way, special cheapness of small industries ought to be clarified.

But over-population has some other important consequences. Admitted that the population pressure exists, the pressure is aggravated by the meager supply of industrial capital. Therefore the problem is not only one of population, but of lack of balance between population and industrial capital. Therefore in a strict sense the over-population theory may mislead the conclusion. If population only were responsible for the formation of small industries, depopulation would be the sole remedy of the small industries problem. This conclusion is, of course, not accepted even by the over-population theory.

c

The third view point tries to approach the problem from industrial capital. According to this, small industries have a special character vis-à-vis large industries in the national economic structure. This type of view may be classified further in various arguments.

The first one defines the position of small industries by competition. "Monopolistic" capital is armed with the power to influence competition for monopolistic gain, whilst, "large" capitals standing as independent capital, small industries are placed in a position of economic subordination. This status of subordination is a general feature of small industries as a whole. In some cases they are bound in organized structure to a parent plants or controlled by the putters-out. In other cases, they seem to compete as free and independent units but in reality they are forced to subordinate status by tacit market relations through price control or financial mechanism, etc. Small industries thus defined consist of two groups. The one may be called as capitalist in nature but is so small that it survives barely with a poor margin of profit. The group represents the "medium" in Japanese small industries. The part of "small" among the so-called medium-small industries fall short of capitalist production. Though it may be an exaggeration to identify them with the old handicrafts and domestic industry, the management and plant do not partake of the capitalist system.

This view is developed ordinarily combined with the overpopulation theory. Therefore it covers most problems of small industries. However, the explanation puts emphasis on the relationship existing between small industries and others. Why the relationship exists and why the various forms of plants from monopolistic ones to small exist side by side are not yet answered.

The second point of view is that of Marxism. It is based on the theory of surplus value. This view classifies capital into three grades, monopolistic, large and medium-small. In semi-feudalistic Japan monopolistic capital is weak and parasitic and enforces profit through the commodity circulation rather than production. Large capital works not as free and independent capital but as a lesser associate of monopolistic capital. Medium-small capital exploits labour and is in turn exploited by bigger capital, and this function of small industries is a necessary basis for bigger capital. Therefore, it is thought that, in backward countries, the monopolistic structure of the national economy necessitates the formation and existence of small industries. Though this method of analysis is broader and more comprehensive than the competition theory, questions remain. For example is it true that no independent or free industrial capital exists at all where monopolistic capital prevails? Though it is said that small industries are exploited by monopolistic capital and barely gain what can be called profit, they are defined as

small "capital". Whether capital structurally deprived of the power to gain profit can be called capital, or whether all small industries can be treated as driven by "capital", ought to be examined by industrial facts.

d

The fourth view is the "structural" interpretation, which may be shown in the following part. This interpretation has something common with above ones, chiefly the third. I have been of this opinion and I think it characterizes the study of small industries in our country.

III. *The "Structural" Interpretation of Small Industries*

The structural interpretation of small industries begins from the starting point of the study of small industries, that is to say, the correct standpoint from which the study ought to be commenced. This may seem an academic trifle and of no practical use to bother about. However, these are not results of abstract thought but of objective research. In other words, the study of small industries has been done from various needs, mostly practical, and from this reflexion on basic conditions has been made.

a

In order to know the nature of small industries one must learn what constitutes small industries. This attitude to approach the problem can be said to be universal not only in Japan but also in other countries. In this way, factors which constitute small industries are found "in" their constitution itself. Thus to see the inner factors which create small industries one must extract those factors from small industries such as those which seem to make up small industries.

This line of study is evidently right. And for this purpose one takes out from general industrial phenomena what one deems to be small industries. Then he concentrates the observation only into the inside of them in order to find proper natures compared with bigger industries. In this course of observation one might take out the size of firms which seems to make them small industries. Of course the size may be one of the most important factors but what is the size which divides small firms from others? To show the size of industries the figure of employees is commonly resorted to. For example, in Japan such a classification is used, industries with under 5 employees being considered "very small", from 5 to 30 "small", and from 30 to 100 "medium", that is to say units which employ less than 100 persons are "small" (in Japanese, "medium-small"). But why are firms which employ less than 100 considered small? Before World War II, the usual size of plants in the Japanese cotton spinning industries was about

600 to 2,000 employees. But one member of the Japan Federation of Cotton Spinning, a world wide known big cartel, was of the size of 350. This firm was exceptionally small among the cotton mills but it was thought in Japan that it was not so small to be classified in "small industries". On the other hand, in Japanese chamber mat production the units were so small that even the biggest did not exceed 30. In mat production a unit composed of 30 persons might be big but it could never be called so in the industry as a whole. It goes without saying that the size which makes some industry or industrial unit small is not something definite. The size which may be called small varies according to branch of industry, historical stage of industrialization and economic conditions of individual nations. A unit of, say, 50 employees may justly be called small but only because of their nature though not on account of size.

It is usual, therefore, to look for other factors than size in small industries. For this purpose the most usual way is to visualize the various conditions upon which small industries founded. The above optimum size theory or over-population theory are examples. That is to say, the nature of small industries and what seem to sustain their existence are taken as a criterion. By this analysis one can approach the inner constitution of small industries. But this method has its apparent deficiencies.

By this method one can grasp many which characterizes small industries. For example, the ability of management, irregularities of demand, backwardness of technical organization, local nature of raw material supply, cheap labour, etc., these may be recognized as factors upon which small industries depend. But these factors are not necessarily always found in every small industry. Each one of small industries possess these factors in various combinations. If one looks for those which have all these factors, small industries will become a small segment of industries, leaving unaffected many which should be really so considered.

Therefore by this method one can enumerate factors which contribute to form small industries. At the same time, one may find himself amidst a heterogeneous mass of industries, losing sight of small industry as a whole.

b

Thus the most practical way to see small industries fails to satisfy us. An advance is necessary to grasp small industries in a more comprehensive way.

There are many ways to grasp the nature of small industries. Some approach it by way of the optimum problem, some by overpopulation, others by cheap labour, etc. The optimum size theory adheres to the rationality of small industries, while the cheap labour theory considers them unsound socially. Is there no single point of view from which the study can grasp the object?

Or is there no renewed point of view which can grasp on the same time the existence and volume of small industries as a whole? Is there no way which is able to explain at once small industries both in their inner heterogeneity as well as in their outer front as one group?

There seem to be at least two ways to which insufficient attention has been paid. The first is the standpoint from which small industries are approached, the second is one which concerns the method of analysis itself. The latter is more important in that it envisages small industries from the structure of the national economy and covers the former. So, in other words, one may say that there is one way of study but not two different ways.

The first attitude may be called "problem" interpretation. This standpoint considers small industries as an economic contradiction and industrial inconsistency. Small industries attract attention because of their nature as an economic and social problem. It is not the size but the social or economic problem which is essential here, because this problem appears to apply to both small and medium industries. If it has no such nature as problems there will be socially no or few need to study small industries.

These problems began when small industries were driven out of existence by competition of the capitalist system. These problems are cheap labour, bad working conditions, low level of technical equipment, financial deficiencies, status of subordination either direct or indirect, cut-throat competition, illogical management, low capital accumulation, etc. In other words; these problems are immovably attached to small industries and will continue as long as the latter exist.

These problems are not constant but variable according to the structural development of the national economy. With the development of problems the sphere of small industries develops also. But, at every stage of the development, it is always this problem and not the mere size that causes the recognition and existence of small industries. In this sense the problem is the body and the size its shadow.

This attitude of envisaging small industries does not, on the other hand, contradict with the following second method as the various problems inherent in small industries are products of the national structure of economy. In other words, the national structure of economy is the mother of the small industries problem as well as of the small industries themselves.

c

The second and more comprehensive standpoint above mentioned is to be called the structural interpretation of small industries.

As above seen, the common way of analysis reveals various parts which constitute small industries, part by part. These parts give only a fragmentary idea of small industries. They show the truth so far as the parts are

concerned, but do not reveal the whole of small industries. By this analysis, one may be lost amidst the heterogeneous mass of small industries and lose sight of them as a whole. But this does not mean that the method is entirely mistaken. The small industries of today consist of traditional handicrafts, sweating industries under the control of putters-out, small machine-equipped factories with passive market relations, plants led by commercial capital as putters-out, factories tied loosely or tightly to parent plants, etc. These are various types of small industries classified according to the form of existence. From financial and technical conditions, management, market conditions, etc., further varieties of small industries could be enumerated. But these varieties are the truth and never consequences of wrong analysis. In reality small industries, heterogeneous as they are, belong to one and the same family, and it is necessary to grasp the nature of this one family as a whole. When one looks for features which they "have", they become heterogeneous units, but if, on the contrary, one looks for what they lack, they can be grouped in one family. The lack is largely the movement of capital culminating in monopoly. Or, if one chooses, one might also name the lack of rationality of large-scale organization.

The reason may be seen without difficulty if the historical background of the birth of small industries is reviewed. From the first, they were no new industries. On the contrary, they were industries of long, old tradition. What made them small industries was a new industrial circumstance, the growth of capitalist production. This meant the appearance of modern large-scale organization. This large-scale rationality led by private capital, in the course of the diffusion of industrialization in the world, has come to be represented by monopolistic organization. The idea of monopoly and concentration of capital may be taken as a general trend. Under this trend small capital which might be considered in the 19th century independent industrial capital but not small industry is placed in a subordinate position similar to traditional small industries. What makes them small industries lies in and outside of them. The outer factor acts on the inner factor, so that the inner factor becomes from that moment the factor upon which small industries are constituted. In other words, these two factors co-exist on the same foundation. These two factors are offsprings of the same root and without this co-existence small industries can never be conceived. Therefore it is not enough in order to grasp small industries to see their inner factors or to see inner factors in relation to outer factors. The true and essential key is the ground upon which both inner and outer factors themselves depend at the same time for birth. This common ground is the structure of the national economy.

The structure of a national economy is a historical product. Strictly speaking, it differs from country to country. We may, of course, admit that several important factors are inherent in every national economy at

whatever place and time, for example, the national structure of productive power in the sense of Walter Hoffmann or Colin Clark, or the national structure of enterprise units such as monopolies, free industrial capital, small industries and old primitive units, or the labour structure such as free modern labour and semi-feudal labour, or the structure of international economic relations as shown by various combinations of import and export both visible and invisible. These various factors have a specific nature as they exist in the historical structure of each national economy.

For example, the conditions for the formation of monopoly are theoretically the same everywhere. But the extent how far monopolies are organized depends on the structural development of each country. In a country like England, capital has till recent times maintained a structural relation which has been specialized by homogeneous or equal capital competition. In the United States and Germany, industrialization was more or less conditioned by the British supremacy already established and development were featured by monopolistic capital. The terms which denote monopoly, cartels and trusts, are German and American but not British in origin. In Japan, where industrialization developed later and in more difficult conditions, the formation of industrial capital was in the main and from the beginning by monopolistic organization.

Their character as monopoly in these countries resulted from increased competition, a tendency toward capital concentration, large scale-organization, technical progress, etc. Nevertheless, their emergence, history, date of birth, relative weight in each society, inner constitution as capital, etc., are not always the same. In other words, theoretically the origin and character of monopoly is one but the conditions necessary for this origin or character are historically fixed by the structure of each national economy.

For small industries the same reasoning can be adopted. This structural point of view answers many questions left unanswered as seen above. For example, it explains why outer and inner conditions co-exist to make small industries. Hitherto monopoly, the antithesis of small industries, has been treated as an entirely different and separated phenomenon from small industries. In a society where monopolistic capital prevails, no small industries, it was thought, can survive. The facts in Japan show that this is not true. Structural conditions in Japan allow the co-existence of monopolies and small industries. From this method of analysis, one can also discern why and to what extent small industries are or are not reproduced in certain countries.

In this sense, small industries are not a simple expression of size in industry. They are an outcome of the national structure of a capitalist economy. They are an industrial phenomenon produced by the characteristics of the national economic structure.

d

For my part, I have been of the opinion that small industries are originally an industrial "problem". As they have this nature, namely, industrial "problem", the public finds the existence of small industries. If one argues the size in industry there are always the differences of sizes. It ought to be noted why at a certain time fixed men find their existence or begin to recognize them. Society find them at the moment when they become certain contradictory or problematic thing on the route of economic progress, though before that time different sizes of industries have not been rare. The situation in Japan may be cited as an example. During the period of her industrial revolution there were small industries but they were nearly unknown. This was possible because they existed as before, not being oppressed by newly born capitals, as I have shown in the article above mentioned.

At the same time, I have also been of the opinion that small industries as well as other forms of industry are a logical offspring of the structure of a national economy. For backward countries efforts towards industrialization are imperative but these are made under the pressure of overpopulation, or competition of advanced countries and against a poor supply of capital, inferior market conditions and lower technical standard. In order to achieve industrialization under these conditions only a few branches can or ought to be industrialized. These branches commonly demand a great burden for the country. Therefore, large parts of the small supply of capital are absorbed in these branches only. In other parts of industry a large part of the working population and a small part of capital are both employed. In this way a tendency is produced for the existence and even growth of industries which are in many a sense below the level of modern industries. In Japan a special fact has, until World War II, aided this tendency, the fact that general consumers have maintained their way of life of their ancestors during the Tokugawa period in an internationally isolated economy. On the other hand, a few branches of industries have attained a relatively monopolistic position in consequence of the unbalanced distribution of capital and thus many industries are placed in an unfavourable position, in regard to the former. These relative process of the birth of small as well as monopolistic industries is a logical outcome of the national economic structure of Japan. Her present economic conditions after World War II present the same industrial tendency, for the destruction of capital equipment by the War together with the growth of population through the sharp decrease of the death rate makes to restoration of economic independence more imperative as the world recovery of productive power is much faster than after World War I.

As regards the results in detail in following the method 'the answer

will be a matter to be treated in an other place than in this article which is a survey of the theoretical interpretation of small industries in Japan. I have analysed historically the subject as far as Japan is concerned in the work above cited by the above outlined methods of interpretation. I hope to relate the results of my own structural analysis on another occasion.

— Written in August, 1953 —

TAXATION AND CAPITAL ACCUMULATION

By MOTOKAZU KIMURA

Professor of Public Finance

One of Japan's most difficult problems is to stabilize her national economy without foreign assistance as was given during the occupation period, and without procurement demands as were offered during the War in Korea. Strenuous efforts will be needed before we can provide a desirable level of economic prosperity to Japan's eighty-six million inhabitants who dwell in a restricted mountainous territory of only 142,000 square miles.

Among other things, it is urgently necessary to make a substantial improvement in productive powers so that we may be able to lower costs of production and thereby compete favourably with foreign countries on the world market. We have not enough efficient capital equipment to remove obstacles standing in the way of any attempt in this direction. Many economists and politicians alike are now discussing means of fostering the accumulation of necessary capital, urging that this accumulation is an essential prerequisite to a successful stabilization of Japan's economy.

Under these circumstances, it is only natural that tax reform should become a serious issue. The present system of taxation contrived in accordance with the Shoup Recommendations has been alleged to be injurious to both willingness and ability to save. As a result the tax reform bills are now under debate in the present session of the Diet, which was given a complete restoration of its legislative power after the ratification of the Peace Treaty concluded in 1951 in San Francisco.

As will be shown later in this article, the Government has, to a considerable extent, complied with wishes and demands vigorously put forward by business circles for tax cuts; and both houses of the Diet are expected to pass the tax reform bills without fail by the middle of August, 1953.

This article intends to examine the recent development of the tax reform movement in favour of an easier accumulation of capital. Before entering into details, I think it is necessary to make a brief preliminary survey of opinions on the nature and significance of capital in its bearing on taxes and public spending.

I. *General Considerations*

It goes without saying that taxpayers always pay their taxes with some abhorrence, regarding them as injurious to capital accumulation.

Taxes are no doubt a portion of social products placed under the disposal of a government, and are always paid either from the capital or from the revenues of a country. Thus, the lower they are, the better the taxes are. This adverse feeling against taxes is, to some extent, unchangeable. Tax-payers may well be said to demand "cheap government" in every case.

It was not until the middle of the eighteenth century, however, that the idea of "cheap government" began to be considered by the ruling class. Before Adam Smith, the maxim "not to impose heavy taxes" had been much more of a moral or political nature than an economic, objective necessity.

For example, political economists, if any, before Adam Smith or the Physiocrats, were apt to insist upon the doctrine that public expenditure usually provides a great stimulus to industry and commerce. They maintained that public spending would not only make "omnipotent" government activities possible, but would increase the velocity of money circulation, and thereby would bring about general briskness on commodity markets. The possible adverse effects of taxation would be alleviated to that extent.

Among the writers of the period of Mercantilism, there were even those who compared taxes to seasonable rains, saying that taxes are collected from a great majority of the people just as calmly as watery vapour is volatilized by sunshine from all parts of the soil, and are used for public purposes just as effectually as rains are used for cultivation.

In addition, many prominent economists before Adam Smith made it a rule to lay stress upon the bright side of taxation, asserting that a tax upon individuals or consumable goods would necessarily stimulate the "diligence and assiduity" of the working class.

Vigorously opposing these arguments, the Physiocrats and, subsequently, the English classical school of economics emphasized the harmfulness of government intervention to economic prosperity and opulence of a country. According to Adam Smith, public spending maintains unproductive, though useful, labourers such as soldiers, officials etc., and public investment, if any, would lead to a disastrous misconduct or waste of national resources. In his view, taxes, too, impede the natural functioning of a "system of natural liberty", i.e., free competitive price-mechanisms, giving rise numerous clashes between tax authorities and taxpayers, and hindering capital from flowing into the most profitable branches of industry. In short, taxes not only deprive individuals of so much revenue or capital, but also impose burdens not to be measured in terms of money—toil and trouble.¹

Also, David Ricardo was of the same opinion. He said that there were no taxes which have not a tendency to lessen the power to accumulate; and that all taxes had to either fall on capital or revenue.²

¹ Adam Smith, *Wealth of Nations*, BK. V. chap. 1.

² David Ricardo, *Principles of Political Economy and Taxation*, chap. VIII.

Along the same line, J. B. Say asserted: *Le meilleur de tous les plans de finance est dépenser peu, et le meilleur de tous les impôts est le plus petit.*³

Smith's doctrine seems to contain an undeniable truth even now. Generally speaking, public expenditure is, in itself, of an unproductive nature. But we should take account of the fact that Smith lived in an age of restrictions in which the most urging task was to remove the many obstacles to effectual industrial activity of the growing number of "self-made" wealthy people. The whole body of Smith's theory is based upon the assumptions that there is no idle money which is laid aside of investment for any appreciable length of time, and that there is no government that knows what the most profitable industry into which to invest public funds is. If these assumptions are no longer valid, we are required to make some fundamental revisions in the theory of the classical school.

In recent economic analysis, there has been growing recognition that savings (exactly speaking, expected savings) do not always run parallel to investment (exactly speaking, expected investment), and if the volume of private investment falls short of the amount of income not spent on consumption, there will be a deflationary tendency in the national economy as a whole, and money capital, however large it may be, will be useless. In this case, savings may be said to be a matter of anxiety instead of congratulation.

Under the influence of J. M. Keynes, the theory of fiscal policy has recently been greatly developed. What is noteworthy here is that the recent theory bears much resemblance to the mercantilistic doctrine in that more attention is paid to consumption and spending, whether private or public. The income-creating effects of expenditure have now been recognized again as a more decisive factor in overcoming economic depressions. To that extent, state intervention or government control over economic activities has also been approved. The active antagonism expressed by the classical school of economics against public borrowing, too, has thus largely been neutralized by the recognition that increased expenditure will give significant stimulus to new investment.

Some prominent writers are now trying to show that a balanced budget with a greater scale alone may fill the investment-saving gap.⁴ Thus, if the argument be proved to conform to reality, taxes may possibly be exalted again to the higher place that was given them by the Mercantilists.

Now that I have shown three different opinions on the nature and significance of capital accumulation in its bearing on taxation and public spending, let us consider the validity of each opinion.

I believe that each opinion has its own extent of force according to

³ J. B. Say, *Economie Politique*, Vol. II, p. 298.

⁴ Trygve Haavelmo, "Multiplier Effects of a Balanced Budget", *Econometrica*, Vol. 13, October, 1945.

the varying circumstances. Each of the three doctrines on a whole corresponds to a particular stage of economic development.

Recollecting that there were an overwhelmingly large number of uneducated people always adhering to old customs and constantly resisting any changes in a mode of traditional life, it had to be unavoidable that enlightened politicians should awake people to secular riches and powers by dint of political regulations. Economic history proves the truth of this view to an important degree. In spite of Smith's refutations, the mercantilistic activities had produced a very favourable, progressive influence upon the economic development of the European countries before modern capitalism was set up on a solid foundation. Government regulation of trade and industry made a substantial contribution to paving the way to a modern efficient economic system, putting aside the medieval residuum such as the guild and manor systems which existed in a stagnant, traditional atmosphere.

Taxes, as distinguished from those feudalistic burdens which were levied upon serfdom, had an incentive effect on free labourers. Self-satisfied household economy was dissolved by taxation to a not insignificant degree.

When market production had once been thoroughly established, the interest of manufacturing industry surpassed that of merchants. The more the system of natural liberty matured, the less state regulation was needed. Stress was naturally to be laid on the dismal side of Mercantilism; narrow nationalistic, militaristic measures originally inherent in mercantilistic policy were condemned. It was undoubtedly true that despotic financial policy many times produced economic disorders and national disasters. It was largely due to the remarkable development of capitalism in the nineteenth century in Europe and in the new world that the theory of the classical school of economics became predominant.

In spite of the fact that, whenever markets became depressed and unemployment grew serious, we did hear bitter complaints against a shortage of demand, the general plea was not raised for government action against depression and unemployment, whether by means of increasing public spending or by direct regulation until the world economic crisis of the year 1929. On account of the subsequent world-wide economic depression, the ending of which no one could guess, accompanied by unemployment to a degree unprecedented in history, firm belief in the system of natural liberty was greatly threatened, and this led to a fundamental revision of the classical theory. The virtual cause of depressions has come to be found not in capital shortage, but in over-accumulation of capital.

If this reasoning is correct, the validity of the three opinions should be carefully judged according to the real circumstances of a particular economy.

There must still be a country where a lack of self-made wealthy, efficient people makes it difficult to attain economic development without authoritative regulations contrived by a small number of selected political economists.

There must be still more countries where the cause of unsatisfactory development of economy should be found not in over-accumulation, but in general shortage of capital.

In a less advanced and less matured economy, reckless money expansion caused by an enlarged budget would produce the adverse effect of raising prices without increasing real products. Of course, no country exists unconnected with the rest of the world. In this sense we cannot imagine a country where no theory but the classical economic one can be adopted to its full extent. But we should remember that the assumption that government expenditure is, on the whole, of an unproductive nature, is applicable with special force to the less advanced economy of Japan. Public spending is, in such a case, likely to produce a resource-exhausting effect rather than an income-creating effect upon the national economy.

The theory of fiscal policy which developed under the sway of the Keynesian doctrine is to be more relevantly applied to a rich and matured economy in which further progress seems to be restrained owing to the lack of market potential enough to digest a huge amount of products.

It seems to me that the theory of fiscal policy chiefly attends to the quantitative aspect of the issue, making little difference between government spending and private. It appears not to pay sufficient attention to the question of whether the increase in national income is caused by public spending or private. This shortcoming, negligible in a wealthy country, may cause a grave problem in a less wealthy, less matured economy. If we are to do justice to the qualitative aspect of the issue, we must recognize the different effects produced by the "exogenous" demand from outside the private economy and the "endogenous" demand arising from inside the private economy. The "exogenous" demand arising from public expenditure tends to deform the whole structure of industry and commerce, especially when public spending is controlled by a nationalistic, or militaristic tendency.

Why do we mention a nationalistic or militaristic tendency? Because experience affirmatively shows that excessive public spending is the gift of war and defence, and it was largely due to military expenditure that the "exogenous" demand led to the unsymmetrical development of the national economy.

I have tried to demarcate the validity of the three different opinions in their bearings upon the real economic circumstances, but it is of course not an easy task to acknowledge an economic reality as relevant to any one of the three opinions. This is true even of an advanced economy that seems to have passed each stage of development—Mercantilism, Economic Liberalism and Modified Capitalism⁵—one after another slowly but steadily. But there are many non-typical countries where each stage appears somewhat irregularly;

⁵ According to W. Sombart, it may be more adequately expressed as: *Frühkapitalismus*, *Hochkapitalismus* and *Spätkapitalismus*.

while the first period is still continuing, the middle period often begins. In less advanced countries, on account of a dire necessity to compete with advanced countries, the length of each period has to be shortened as much as possible. In compressing the growth of centuries into generations, an incongruous story appears.

II. *Historical Survey*

If we are allowed to follow the model of W. Sombart, Japan's modern economic history, too, may be divided into three stages as follows:

- (a) Mercantilistic Stage, or *Frühkapitalismus* (1868-1912)
- (b) The Stage of Economic Liberalism, or *Hochkapitalismus* (1913-1928)
- (c) The Stage of Modified Capitalism, or *Spätkapitalismus* (1929-)

This division is made entirely for the sake of convenience. According to W. Sombart, capitalism was blooming in the years 1830 to 1913. In this sense my division may seem absurd. But an outstanding characteristic of Japan's economic development is, as was suggested above, that it can not be easily analyzed with the method generally applied to economic development in advanced countries. Viewed from the point of politics, Japan replaced political regulations peculiar to Mercantilism soon after the Meiji Restoration in 1868, and it was 1889 that she introduced the representative system fairly successfully. But in view of a large scale of government activities, Japan was far behind the west in the growth of economic liberalism. In a sense, it is not too much to say that Japan has never enjoyed the full bloom of liberalism in its strict sense of the word.

The economic development of this country, remarkable as it was, was, to an important extent, due to the active policy carried out by Government. We may safely say that from the very beginning of the new regime, the ruling class betook themselves to an excessive strain on the financial resources of the country.

The correct official statistics are not available for the purpose of affording bird's-eye view of the whole development. Relying upon the figures for national income, elaborated by Dr. Yuzo Yamada⁶ I computed the ratio of national expenditure to national income (see Table I on p. 21.).

If we acknowledge that, when Japan began to introduce modern institutions, she was an overwhelmingly agricultural country, and the level of her national income was extremely low, then, we must admit that, in order to create new institutions and foster a new mode of production unknown to her people up to that time, it was a positive necessity for Japan to adopt a mercantilistic type of policy until the end of the Meiji Era (1868-1912).

⁶ Yuzo Yamada, *Materials for Estimating National Income of Japan* (in Japanese), 1952.

Table I National Income and Government Expenditures
compared on an average of every five years
(In millions of yen)

Year	National Income ¹	Government Ex- penditure ²	Ratio per cent
1883—1887	(395) ³	79.0	8.4
1888—1892	968	100.1	10.3
1893—1897	1,095	188.7	17.2
1898—1902	1,851	268.3	14.5
1903—1907	2,787	877.6	29.7
1908—1912	3,503	698.0	19.9
1913—1917	4,507	812.7	18.1
1918—1922	12,031	1,888.3	15.7
1923—1927	12,754	2,073.0	16.3
1928—1932	11,911	1,801.0	15.1
1933—1937	14,376	2,424.9	16.9
1938—1939 ⁴	22,225	8,551.0	38.5
1940—1941 ⁴	27,916	12,495.5	48.4
1942—1943 ⁴	37,877	31,203.5	82.4
1944	50,901	93,366.0	183.0
1945	—	30,755.0	—

¹ National Income distributed

² General Account and War Expenditure Account

³ National Income produced

⁴ Average of two years

During the mercantilistic period of Japan, what is conspicuous to present students is that the Government collected many taxes from peasants and consumers. On the contrary, manufacturers and carrying traders were encouraged with subsidies and other financial aids. Many public funds were outlaid for the purpose of a "Wealthy and Strong State", a slogan typical of mercantilistic ideas.

The tax charged peasants was the land tax. It was very heavy and aroused many revolts among the farmers in the early period of the Meiji Era. This tax drew nearly fifty million yen, more than eighty per cent of all tax revenue until 1877, and never fell below fifty per cent until 1895.

Another major item that constituted a large part of tax revenue was the excise tax.

Taxes upon consumer goods ranging from liquor to cakes were gradually increased to hold first place in tax revenue after 1896. For example, in 1911, thirty-four per cent of all tax revenue was derived from the tax on

Sake (Japanese liquor), soy, sugar, textiles, and oil. Profits of the Tobacco Monopoly amounting to more than sixty-six million yen, if included, would add greatly to the percentage of excise revenue.

As will be shown later,⁷ another important feature of the period under discussion is that foreign loans amounting to more than 11 billion yen had been contracted by 1907. We should attach more importance than is usually placed, to the role that foreign loans played in encouraging Japanese economic growth during the Meiji Era.

Now, let us turn our eyes to the second period.

As I have said, the period of economic liberalism was strikingly short. It was the first World War that provided Japan with the necessary prerequisite to the sudden rise of free competitive capitalism. During the War, Japan could take advantage of her entirely favourable position on the world market. The period of fifteen years from 1913 to 1929 seems to have been the only blessed period for Japan. She could enjoy the blessings of peace. The Government tried, for the first time, to keep itself from meddling much in economic activities of the private sector.

A remarkable rise in the standard of living, a vigorous growth of wealth, an unprecedented accumulation of foreign exchange funds caused by a boom in exports, and so on; all these advantageous circumstances could not but reflect upon public finance. One of the great achievements in this period was an enormous increase in the revenue provided by the income tax, which may well be said to satisfy the modern principle of taxation—the principle of ability-to-pay.

When the War came to an end in 1919, tax revenues of this country were as follows:

Table II Tax Revenues in 1919
(In millions of yen)

Taxes	Amount	Per cent
Land Tax	73	7.9
Income Tax	193	20.7
War-time Profit Tax	162	17.4
Excises	227	24.4
Custom Duties	82	8.8
Others	196	20.8
Total	933	100.0

Table II shows that the land tax fell decisively in importance, and instead of this, direct taxes such as the income tax and the war-time profit

⁷ See below p. 31.

tax rose in significance. During this period the outstanding national debt was increased owing to the great earthquake in 1923, but the financial condition was, on the whole, quite satisfactory.

But this favourable condition was not sustainable. Because, under the surface of prosperity, there was a structural contradiction in the Japanese economy. What was the structural contradiction? It was what was left behind after the war boom. What remained after the war boom?

After the war boom there remained an inflexible economy imbued with the spirit of Mercantilism. A lack of "endogenous" demand could not be cured with a short-term prosperity caused heteronomously by the outbreak of World War I. There was an appalling discrepancy between the unproportionally well-equipped huge industries on the one hand, and the miserably ill-equipped small-size industries, on the other hand. There was also a keen discrepancy between cities and villages, and there was a sharp contrast between plutocrats who had a close relation to state power, and the millions of ill-paid labouring masses.

The third stage was ready to begin.

Facing the world depression starting in 1929, it was only natural that business circles should have again sought after Government assistance. The effort to overcome the depression soon tended towards political arrangement to secure a particular market for Japanese exports. And this political programme to establish a Japanese sphere of influence, of necessity, made international relations important. The more serious the necessity to overcome economic difficulty became, the more acute the defense problem was. And the more the defense programme enlarged, the more acute became the necessity to secure war stores and raw materials abroad.

These circumstances were quickly reflected in the budget, which, in the fiscal year, 1932-33, is to be remembered as having given plain indication that a militaristic policy had begun to establish its supremacy in budget making as well.

After 1933, the ministers of finance had to give way to fresh borrowing. While at the end of March, 1930, the Government was in debt to the amount of nearly six billion yen, or fifty five per cent of the national income, the increase in national debt in the succeeding years was quite appalling in amount. To make the matter intelligible, I will show the growth of national debt as well as the changes in price index in the period covering eighty years.

Table III The Total Amount of the National Debt
as shown at the end of selected fiscal years
(In millions of yen)

Year	Total	Domestic Loans		Foreign Loans		Price Index 1873=100
		Amount	Per cent	Amount	Per cent	
1877	226	213	94	13	6	111
1897	399	399	100	—	—	170
1907	2,254	1,088	48	1,165	52	249
1914	2,506	991	40	1,514	60	243
1924	4,863	3,356	69	1,506	31	526
1930	5,955	4,476	75	1,479	25	349
1936	10,574	9,257	88	1,316	12	408
1945	140,810	139,922	99	887	1	1,380
1949	391,509	290,853	74	100,656 ¹	26	82,253
1952	404,983	302,657	75	102,326 ¹	25	137,650

¹ The increase in Foreign Loans in these years is due to a change in the rate of exchange.

From the fiscal year, 1932-33, because the attempts to improve tax revenue did not bring about the desired effect, enormously increased government expenditure had no way to be defrayed except from the proceeds of domestic loans issued.

But under the pressure of financial strain, the taxation system underwent substantial changes in 1940 in the anticipation that the use of the armed forces in the Asiatic Continent should cause a greater financial difficulty. Among others, the most important changes were a great extension of the income tax to the lower-income groups previously exempted from it, and the co-ordination of miscellaneous taxes introduced during the "China Incident".

When Japan declared war against the United States of America and the British Commonwealth of Nations, the tax burden was no less tolerable. Soon after a temporary success in the aggressive attack of 1941, Japan found it difficult to compete with the enemy's huge productivity. War production was desperately encouraged at the cost of daily necessities.

Under these circumstances a noteworthy change was produced in tax revenues. As the production of consumer goods decreased, taxes upon profits and wages began to surpass those upon goods, in yield. The direct-tax-principle was unexpectedly realized under the pressure of war-time control.

In spite of great expansion of public credit, the financial problem seemed to offer no insuperable difficulties, because the inflation gap was seemingly filled up by such measures as a semi-compulsory saving plan to urge individuals to purchase public bonds with their salaries and wages.

As long as the war continued, inflation was checked, to a successful extent, by a strict rationing programme and by price regulations.

At last, however, the catastrophe came. Owing to a sweeping crack in the worn-out mechanism of war economy, a free outlet was given to pent-up evils. There were tremendous ravages of war on the one hand, and huge amounts of money assets on the other hand. The lack of adequate fiscal and monetary policy gave rise to a vehement inflation.

This stormy inflation made the taxation system completely unworkable. Tax collecting agencies could no longer keep track of enormous profits which arose from black market trading, while wage-earners were forced to pay income taxes withheld and collected at the source of payment. Although nominal wages were belatedly raised on account of an increase in prices, the burden upon labourers was both intensively and extensively augmented.

But, as long as inflation continued, taxpayers did not pay much attention to tax reform, because manufacturers and dealers were being satisfied with larger profits compared with taxes which they could belatedly pay with depreciated currency, and wage-earners were too busy seeking higher wages to reflect upon tax reforming.

It was in 1949, when an organized effort was successfully made to overcome inflation under the leadership of SCAP, that tax reform became an urgent problem for taxpayers. And it was in that year that the Shoup Mission was sent to Japan to recommend a reasonable tax system.

III. *The Shoup Recommendations and Capital Accumulation*

The Shoup Plan was put into effect in April, 1950. Objectives, that the Shoup Mission aimed at, were by no means incomprehensive; for example, it laid stress on the necessity to designate productive taxes to municipalities (except prefectures), to check the overgrowth of plutocratic power, to avoid taxes not helpful in fostering citizenship, morale, and democracy, and last but not least, to satisfy the modern principle of taxation as much as possible—the principle of ability-to-pay as the standard of equity.

But it must be borne in mind that the "Report on Japanese Taxation", nevertheless, paid much attention also to the problem of how to encourage the accumulation of capital.

In view of recent assertion made by many writers and businessmen, that the Shoup-Plan is not favourable to the rapid accumulation of capital, we should review the extent to which the Mission took account of capital accumulation, and the basis on which the Mission advocated its tax system plan as not harmful to capital accumulation.

Needless to say, it is on no occasion an easy task to reconcile capital accumulation with the other objectives of taxation. And the "Report on Japanese Taxation" may be said to be an elaborate display of painstaking

scientific work. Those who read the report will easily understand what I mean. It has a remarkable coherence.

Where does this coherence come from?

Though with necessary reservations, I dare say that this coherence seems to be maintained by a rationalistic philosophy common to those who grow in the countries where economic liberalism has deeply taken root.

According to this philosophy a society is considered as composed of concrete person; society is but the aggregate of individuals. Corporations are also reducible to partners or share-holders. Business corporations are, as it were, agents taking charge of the production and distribution of social products. Accordingly it is only for convenience' sake that legislation orders business corporations to pay taxes; in reality it is not the corporations or partnerships, but the persons who compose them, that should pay taxes. By this view, it is supposed, all income is to be distributed among the members of a society; if a part of incomes should be saved, it is not the corporations or partnerships, but individuals who take charge of saving money.

By the same reasoning, it is asserted that equity in taxation should primarily be a matter among individual income recipients. Therefore, so far as business is concerned, a matter of substantial importance is to prevent a business from losing unduely in its relative ability to compete with other businesses on account of "unfair" taxation.

Let us consider, with reference to capital formation, the way in which such a clear-cut philosophy is embodied into the tax system recommended by the Shoup Mission.

A. Tax Cuts in favour of Higher Income Groups

The Shoup-Plan recommended that the top rate of the income tax should be reduced to fifty-five per cent for incomes over ¥ 300,000 (\$ 833), considering the necessity of fostering the willingness and ability of the high income bracket to save, and to weed out the maladministration of tax collecting agencies.

According to the tax reform enforced, the top rate of fifty-five per cent was to be applied to incomes over ¥ 500,000 (\$ 1,388) instead of the ¥ 300,000 proposed. In order to explain the extent of reform, I will show the following table.

Table IV Income Tax Rate Schedules Compared

Net Yearly Income after Exemptions etc.				1949	Shoup-Plan	1950
				%	%	%
0	to	20,000	yen	20	20	20
20,000	to	40,000		25	20	20
40,000	to	50,000		30	20	20

50,000	to	70,000	30	25	25
70,000	to	80,000	35	25	25
80,000	to	100,000	35	30	30
100,000	to	120,000	40	35	35
120,000	to	150,000	40	40	40
150,000	to	200,000	45	45	45
200,000	to	250,000	50	50	50
250,000	to	300,000	55	50	50
300,000	to	500,000	60	55	50
500,000	to	700,000	65	55	55
700,000	to	1,000,000	70	55	55
1,000,000	to	2,000,000	75	55	55
2,000,000	to	5,000,000	80	55	55
	over	5,000,000	85	55	55

As was indicated above, a sudden change from inflation to deflation was indescribably active in causing friction between tax agencies and taxpayers. It was an urgent necessity to increase the level of compliance, assessment and collection so that a reasonable degree of enforcement could be obtained. The Shoup Plan expected that a sharp reduction in the top rate of the income tax would increase the level of compliance, etc.

This reduction was to be favourable also to incentives, production and investment, the Report stressed.

But at the same time what is noteworthy is that the following three counteracting steps were contrived against the reduction of the income tax.

Firstly, the Shoup Report urged with all the emphasis at command the necessity to include all incomes in the taxable incomes; incomes, whether from royalties, or capital gains, or fluctuating revenues, were proposed to be subject to the progressive rate of the income tax.⁸

Secondly, a net worth tax was proposed to fill the gap left by the reduction in the top rates of the income tax. The rate schedule of the net worth tax recommended was as follows:

Table V The Net Worth Tax

Networth Bracket (Yen)			Rate of Tax
less	than	5 million	Exempt
5 million	to	10 million	0.5 per cent
10 million	to	20 million	1.0 per cent
20 million	to	50 million	2.0 per cent
	above	50 million	3.0 per cent

⁸ The "Report on Japanese Taxation" says: "Indeed, it cannot be so strongly emphasized that inclusion of the full amount of capital gains, other than those attributed to inflation, is a basic cornerstone of our program of tax reform and that no departure from this principle can be admitted without seriously impairing the coherence of the program." (Appendix B, p. 11.)

The introduction of a net worth tax (as well as the proposed increase in the estate and gift tax) was expected to check the growth of undue concentration of economic power. With regard to an adverse effect the new tax might have upon the "due" accumulation of capital, the recommendation asserted that this form of taxation would produce less impairment of good management and industrial efficiency than income tax at comparable rates. In addition the Shoup Mission tried beforehand to refute objections presumably taken against such an ordinary property tax as the net worth tax, saying that its very existence would induce "intelligent" taxpayers to make more efficient use of their assets.

Thirdly, the Shoup scheme granted a credit for each individual stockholder against his individual income tax of an amount equal to twenty-five per cent of the dividends he receives from corporations subject to a tax of thirty-five per cent on their net income.

This arrangement, as was suggested above, clearly corresponds to the idea that a corporation is but an aggregate of individuals, formed for the purpose of carrying on a given business and distributing its net income. According to this idea, there will be an impermissible double taxation, if no credit is allowed for shareholders. This credit for shareholders was to foster willingness and ability to save and invest.

B. Efforts to Improve Business Relationships

If inclusion of all incomes of whatever kind, and, if possible, application of direct, and progressive tax to them was one of the cornerstones of the Shoup Programme, the other one was, speaking broadly, repeal or reduction of taxes that were likely to prevent the competitive relationship of business from coming into existence to its full degree.

When the Mission was sent to Japan, business relationships were badly malfunctioning. And it caused great bitterness for business to have been forced to submit to taxes utterly spoiled by inflation. The Shoup Mission gave much attention to this issue.

First of all, the excess profits tax was pounced upon. This tax was in the exemplar pattern of taxes that cause unfair relationships, because it was a "mockery" to impose a tax upon "excess profits" that were computed on the basis of a book value having nothing to do with the current value of the assets.

The same unreasonableness was to be found in the taxation of "ordinary profits". After paying tax upon fictitious profits, business could not maintain industrial capital at its existing level.

The Recommendation urged the necessity of writing up the *yen* value of assets in the hands of business concerns, provided that this write-up in value be subject to the revaluation tax of six per cent.

What deserves our attention in this case is that, according to the

programme, all corporations were required to write up the value of their depreciable assets and land, as of July 1, 1949, and to file a complete re-valuation return by September 1, 1950, if they were to receive the benefit of increased depreciation for the corporation income tax.

Along the same line, many other improvements in the method of computing profits were recommended. But we should remember that the programme did not intend to discriminate between businesses according to political decisions upon the degree of their importance.

With regard to a tax on a value-added base, it is noteworthy that the Shoup Mission expected favourable effects upon modernization of capital equipment.

A scheme to make corporations pay an interest surcharge of one per cent each year on accumulated earnings reserves was, according to the Mission, necessary to counterbalance the pressure for "undue" accumulation of earnings which arises from the progressive income tax on shareholders. This scheme, too, was obviously in exact accordance with the specified conception of corporate form.

It was mainly due to the idea of fair business relationships and the principle of ability-to-pay that the Mission recommended the abolition of, or reduction in, many indirect taxes except the excise upon liquor and tobacco. Thus, the transactions tax, the textile tax, the sugar tax, the soft drinks tax, the tax upon transfer of securities, and the registration tax were to be repealed; and the commodity excises, the tax upon travelling etc., were to be reduced.

Only the liquor tax, the revenue of the Tobacco Monopoly, the commodities tax, and the gasoline tax were justified for various reasons.

Taken altogether, we may be able to conclude that the Shoup-Plan, on the whole, rested upon orthodox economic liberalism with regard to the fostering of capital accumulation. The plan did not favour fostering government investment, nor increasing corporation surplus reserves etc. It counted solely upon voluntary saving and direct investment on the part of "intelligent" wealthy people.

IV. *Modifications of the Programme commenced soon after its enforcement*

In spite of the valuable effort exerted by the Mission to rationalize the Japanese taxation system in accordance with the emphasized principle of ability-to-pay, the tax burden upon the lower income brackets was not reduced to a satisfactory extent, because the decrease in the top rate of the income tax did not much affect incomes below 120,000 yen, as was shown on Table IV on p. 26-27.

And tax administration was not improved as was expected with regard to the self-assessed income tax. But, on the other hand, those subject to

the income tax withheld and collected at sources were forced to pay their taxes to the letter of the law.

An inflationary tendency took place again, owing to the outbreak of the War in Korea. Wages were, though belatedly, raised in the wake of an increase in prices and profits. This made it necessary to revise the rate schedule of the income tax, and to increase the exemptions, the dependency allowance, the earned income credit, etc. There appeared, nevertheless, a conspicuous contrast between the rising revenue of the tax withheld and the declining revenue of the income tax self-assessed.⁹

Reduction in the income tax upon the lower income groups, in itself, by no means indicates a departure from the principles advocated in the Shoup Recommendations. The Government actually tried to reduce taxes in this direction.

The principle of including all incomes in taxable income, though stressed emphatically in the Report, underwent much resistance from the very start.

Firstly, the loophole, for concealing interest income was not completely closed. Wealthy people could spread their deposits anonymously in large numbers of tax-free accounts. Secondly, the optional flat rate (sixty per cent) on interest income was abolished in 1950 only to be re-introduced in the following year with lower rate of fifty per cent. Thirdly, the inclusion of capital gains in taxable income was substantially invalidated owing to the fact that fierce opposition against the registration of all the transfers of shares induced the government to neglect the Recommendations.

There were also other items which represented a departure from the Recommendations. For example, the business tax on a value-added basis was postponed indefinitely; administration of the net worth tax was scarcely improved.

While the Shoup-Plan recommended that business should write up the value of its fixed assets once and for all, the Government allowed repeated revaluations.

In disregard of the Shoup Programme, the Industrial Rationalization Promotion Act of 1951 allowed specified branches of industry to write down fifty per cent of the price of machinery for two years including the year of acquisition.

Furthermore, it was also suggestive of the future of the direct tax principle, apparently proclaimed in the Report, that the sugar tax was not abolished.

We can thus indicate many modifications. Of course it is doubtless that the taxation system of Japan as a whole was reorganized in accordance with the Recommendations. Modifications were, it should be remembered, apparently slight. But at the same time we must be attentive to the grave significance involved in the modifications. They were suggestive of a fun-

⁹ See below p. 35.

damental change in the two cornerstones: the principles of inclusion of all incomes as taxable income on the one hand, and of ability-to-pay or direct taxation on the other hand. Let us consider the subsequent development of the Japanese taxation and taxes with reference to capital accumulation.

V. *Demands of Business Circles and the Recent Tax Reform*

To begin with, we should give a glance to the changed economic conditions since 1951. As was mentioned above, the War in Korea began in June, 1950. The expansion of the war caused a world-wide boom on the war products market. On account of its geographic nearness to the front, a large number of war procurement contracts were given to the industry of Japan. The Korean War boom had a deep effect upon the Japanese economy which has only poor productive powers. There was again a steep rise in prices and wages.

Under these circumstances, the pressure for dollars and pounds was alleviated, and the brisk market made business circles temporarily forget the seriousness of improving industrial efficiency.

But as the Korean War waned and was soon expected to end, the increased costs of production of necessity caused Japanese industry greater difficulty. So tax cuts for the sake of capital accumulation have once more become urgent.

In the fourth assembly of the Japan Tax Study Association, the financial circles urged the necessity of (a) reducing both the rate of the withheld tax and of the optional flat rate of tax upon interest incomes arising from deposits and others, (b) allowing depositors a credit against their individual income tax, (c) exempting long-term deposits from taxation. The stock-dealer circles insisted on, (a) the exemption of capital gains from income tax, (b) the reduction of tax upon dividends on the additional capital paid in cash. The industrial circles formulated the draft of the "Capital Accumulation Promotion Act".

The draft of the "Capital Accumulation Promotion Act" was published in November of 1952 by the "Business Companions Club". The act was to promote the accumulation of capital stock primarily through a substantial reduction of taxation upon business. It contained the following items:

- (a) Extension of the special depreciation system and reduction of the service life of assets
- (b) Extension of the system of reserve against changed prices
- (c) Extension of the limit of bad credit reserve
- (d) Enforcement of the third revaluation of capital assets with the six per cent revaluation tax (extension of the spread of taxpayment from three years to five)

- (e) Reduction of taxation upon a surplus reserve within a limit of, say, fifty per cent of profits
- (f) Exemption from the corporation tax for dividends within a limit of, say, ten per cent
- (g) Abolition of tax upon capital gains.

The Ministry of Industry and Foreign Trade also published a plan to reform taxation along the same lines, laying special stress on the necessity of improving the export industry. In addition to items similar to those mentioned just above, there were also such items as apparently represent the prevailing opinion of the business circles on the property tax and the value-added tax: the plan urged abolition of these taxes altogether.

It is needless to give more examples.

Largely influenced by these demands, the Cabinet under Premier Yoshida, President of the Liberal Party, contrived tax reform bills to be introduced before the Diet early this spring. Owing to the political unrest and the subsequent general election, the bills have not yet been carried, but there is now nothing to suggest their failure.

Let us survey the important points of the recent tax reform bills.

As was pointed out above, business was allowed to write up the value of fixed assets in 1950. The second valuation was admitted in 1951. The recent reform of the Revaluation of Assets Act prescribes that business will be allowed to resort to a third revaluation with the benefit of spreading the revaluation tax payments over five years.

The recent reform plan admitted an extension on the limit of several reserves and establishment of new reserves for the export contracts cancelled, etc.

The value-added tax was to be again postponed indefinitely.

Grave impairments of the Shoup Principles are that, according to the reform bill, capital gains will be excluded from the taxable income tax, and instead of this, subjected to the tax upon transfers of securities, and that the ten per cent tax will be introduced to do away with any other taxation upon interest incomes.

Wealthier people will be altogether freed from the net worth tax by the repeal of the Net Worth Tax Act. On the other hand, they will be subject to an increased rate of income tax of sixty per cent on their incomes over three million yen, and sixty-five per cent on those over five million yen.

The National Savings Bond Act will also afford much benefit to wealthier persons, because the Act prescribes that purchasers of bonds will be allowed to pay their income tax or corporation tax at a discount of a specified ratio in proportion to the amount of bonds purchased.

Another noteworthy feature of the recent tax reform plan is that the rate of the sugar tax will be raised by twenty per cent, and the tax upon transfers of securities will be restored.

VI. *Priority of Tax Reductions*

The Government has been keen about tax reductions, and proud of the recent reform bills, insisting that they will give relief to taxpayers to the amount of 100 billion yen.

It is indeed true that the paper reduction in the letter of the tax laws amounts to more than 100 billion yen. And it is also true that, on the surface, there will be no taxpayers whose tax may be increased more than in proportion to increases in their incomes. But in so far as we take it for granted that the retrenchment of Government expenditure is impossible, fair reduction in taxes is difficult. Tax reductions in favour of capital accumulation may perhaps mean an increased taxation upon those who are deemed to make no valuable contribution to the accumulation of capital stock.

As I endeavoured to show in my article published in 1952, the ratio of direct tax revenue to indirect tax revenue does not necessarily indicate the propriety of a tax system,¹⁰ but in the light of recent developments, a decline in the ratio of direct to indirect tax revenue denotes a receding tendency on our tax system as a whole, because direct taxes have been improved upon, since 1950, at least in comparison with indirect taxes. The following table shows the changes in the ratio of direct to indirect tax revenues in the National Budget.

Table V Ratio of Direct to Indirect Tax
Revenues in the National Budget
(In millions of yen)

Year	Total		Direct Taxes		Indirect Taxes		Others	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
1920	1,179	100	385	32.7	691	58.6	102	8.7
1935	1,202	100	420	35.0	687	57.2	93	7.8
1940	4,218	100	2,695	63.9	1,288	30.5	234	5.6
1945	11,541	100	7,334	63.5	3,500	30.3	707	6.2
1949	636,406	100	344,374	54.1	243,783	38.3	48,249	7.6
1950	570,547	100	313,625	55.0	245,779	43.1	11,123	1.9
1951	723,141	100	424,997	58.8	285,921	39.5	12,224	1.7
1952	844,041	100	475,615	56.4	352,093	41.7	16,330	1.9
1953	859,843	100	455,016	52.9	383,587	44.6	21,240	2.5

(1) Figures are shown according to settled accounts, except for 1952, in which anticipated accounts were used, and for 1953, in which estimated accounts were used.

(2) Including profits of the Tobacco and Alcohol Monopolies.

¹⁰ M. Kimura, Conditions for Direct Taxation, *The Journal of the Hitotsubashi Academy*, April, 1952.

In the budget for the fiscal year, 1953-54, the estimated increase in indirect taxes is 31.5 billion yen, whereas, direct taxes are to be decreased by 21 billion yen, as compared with those in the previous year. This decidedly denotes the unhappy future of our taxation system.

Indeed, if the decline in the ratio should be compensated for by a great improvement in direct taxation, that would alter the case. But unhappy reality is that the decline in the ratio of direct to indirect tax revenue is being accompanied by an unsatisfactory tendency in direct taxation.

I have repeated that the income tax administration was far from satisfactory, especially with regard to the self-assessed parts of it. This tendency still persists and the Ministry of Finance each year is forced to concede its failure.

Indeed the income tax law has repeatedly been revised in favour of taxpayers. For example, the basic personal exemption was raised from 15,000 yen in 1949 to 25,000 yen in 1950 (according to the Shoup Plan: 24,000 yen); to 30,000 yen in April of 1951; to 38,000 yen in September of 1951; to 50,000 yen in 1952; and by the Special Tax Treatment Act of 1953, it has now been raised to 60,000 yen. The credit for dependents was also raised accordingly from 12,000 yen for each dependent in 1950 to 35,000 yen for the first dependent and 20,000 yen for each of the rest of the dependents in 1953. As a consequence of these raises the number of those who are subject to the income tax is now expected to be 8,307,000 persons, showing an enormous decrease compared with the strikingly large number of 21,397,000 persons in 1949. Those who file returns will also be reduced in number to 3,170,000 persons as compared with an amazingly large number of 11,723,000 persons in 1949.

This is, indeed, a remarkable improvement in the income tax. But if we take account of the pre-war income tax, which I mentioned above as a great achievement in our public finance, we should admit that the recent improvement is but trifling.

In the pre-war period from 1934 to 1936, the personal exemption limit was 1,200 yen (yearly). The real value of this 1,200 yen is equal to at least that of 319,200 yen (yearly) in 1953, if adjusted by the Consumers' Price Index. In spite of the fact that the ratio of direct to indirect tax revenues was 34.8 : 57.1 in the pre-war period, and taxes upon liquor, soft drinks, textiles, sugar, tobacco, etc., were substantially heavier than now, the income tax must, nevertheless, have been far less oppressive for the lower income brackets, since the single income-earner of 319,200 yen previously exempted from the income tax is now required to pay more than 54,000 yen, that is to say 18 per cent of his revenue.

As was shown before, business circles have eagerly requested a reduction of taxes upon business. In an excess of eagerness, some of the influential industrialists and their spokesmen have advocated even an increase in indirect

taxes to recompense for a decrease in taxes upon business. Such an opinion is not frequently expressed, but we may safely say that the underlying tendency in business circles is generally in favour of an increase in indirect taxes. But it is doubtful whether such an opinion has any justification.

For the sake of brief illustration, let us put aside the effect of all taxes other than the corporation and the income taxes. In 1934-36, the revenue of the corporation tax (then the income tax of the first kind) was 97,111 thousand yen per year on an average of three years, whereas the personal income tax (then the income tax of the third kind) drew 11,089 thousand yen. Computing the ratio, we get 46.6 : 53.3. Since the personal exemption limit was, as mentioned above, 1,200 yen (yearly) in 1934-36, it may be concluded that the personal income tax was, to a great extent, paid by those who lived upon revenues arising from property or dividends. In other words, the income tax at that time did not affect the low income group of wage-earners. Recent developments in extraction of revenue from the income tax and the corporation tax are as follows:

Table VII Revenues of Corporation Tax
and Income Tax Compared¹
(In billions of yen)

Year	Corporation Tax		Income Tax					
			Total		Withheld ²		Self-Assessed ³	
	Amount	Ratio %	Amount	Ratio %	Amount	Ratio %	Amount	Ratio %
1947	7.1	9	79.2	91	27.9	32	51.3	59
1948	27.9	13	190.8	87	76.4	35	114.4	52
1949	61.2	16	278.7	82	141.5	42	137.2	40
1950	83.7	28	220.1	72	127.5	42	92.6	30
1951	149.4	39	234.5	61	132.2	34	102.2	27
1952	186.0	40	269.8	60	186.8	41	83.0	19
1953	170.1	39	267.1	61	191.8	44	75.3	17

¹ Corporations pay a Revaluation Tax of 13 billion yen per year on an average in addition to the corporation tax, but we omitted this tax.

² A large part of the income tax withheld and collected at sources falls on the shoulders of the wage-earner: for example, it is estimated in 1953, 164.4 billion yen out of 191.8 billion yen will be paid by recipients of earned incomes.

³ Those who are requested to file returns are, in most cases, wealthy people.

Table VII reveals notable facts, for example,

- (a) that the revenue of the self-assessed income tax has been decreased since 1950,
- (b) that the earnings of corporations have been steadily increased,
- (c) and that, despite frequent reductions of the rate of the income tax,

the burden upon earned incomes has not been virtually alleviated.

In this connection, it is noteworthy that a large number of personal business enterprises has been reorganized into the corporate form. There were about ninety thousand corporations in Japan in 1934-1936. Since then their number had been usually augmented by ten thousand every year. But in 1947 the number jumped from 106,000 to 144,000, in 1948 to 207,000, in 1949 to 207,000, and in 1950 to 230,000. This remarkable tendency, though slowed down, has not disappeared. An increase in the number of corporations may be attributed to several causes, but such a striking increase as is seen in Japan cannot be adequately explained without taking account of the fact that the income tax is more intolerable than the corporation tax.

The great fall of the self-assessed income tax in its importance may, too, to a considerable extent, be explained by the same reason.

There is unsatisfactory administration of the self-assessed tax. Even the official publication admits that only eighty per cent of the self-assessed income tax will be collected within the present fiscal year, as compared with ninety-six per cent of the withheld income tax. This low rate of collection no doubt reveals on the one hand, the advantageous position of the self-assessing taxpayers, but, on the other hand, it seems to signify an unsatisfactory relation between the tax officials and taxpayers. This dissatisfaction appears to be one of the important reasons why merchants and manufacturers wish to reorganize their concerns into the corporate form. In the case of corporations, the flat rate of forty-two per cent (the rate was raised in 1952 from thirty-five to forty-two per cent) is by no means an insignificant tax burden upon business, but corporations can save much trouble involved in "negotiating" with tax agencies in computing net profits.

If there is no reason, in principle, either to encourage individuals to make use of the corporate form or to deter them from using it, and if there is an actual tendency for taxes to induce individuals to utilize the corporate form, then the taxes well deserve revision.

And if it is true that the income tax withheld and collected at sources, (in practice, just like indirect taxes collected without evoking much disgust from taxpayers) has, on its own accord, an adverse effect upon true citizenship, morale, and democracy, and upon the principle of ability to pay as our standard of equity, it is, surely, not the corporation tax, but the withheld income tax that has prior claims for reduction.

However, viewed from the standpoint of capital accumulation, it may be desirable that business acquire a priority in tax reduction.

The more priority we give to business, the less easy it is to reduce the withheld tax or indirect taxes.

Now, the banking circles have successfully urged the Government to reduce the tax upon interest revenues to such an amazing extent as to allow bank depositors to pay no tax other than the withheld ten per cent

tax upon their interest revenues.

There can be no doubt that such a great reduction of taxation will encourage bank savings. But at the same time, we should recognize that bank deposits have been increased without tax reductions. Indeed it is true that the low rate of interest is essential for a sound handling as well as a low working cost of business, and tax reduction upon interest incomes will help to lower the rate of interest, thereby contributing the augmentation of Japan's stock of capital equipment. But the reason why the rate of interest is high in Japan is not simple. A high rate of interest cannot be attributed to heavy tax alone. In the prewar period, interest payment amounted to nearly sixty per cent of all the costs of loanable funds of banks. To-day the ratio of interest payment to the costs of loanable funds is only twenty-five per cent. Such a great difference is largely due to a startling increase in the working expenses as well as the profits of banks. If the rate of interest is to be lowered, the first step must be to reduce the amount of these two items.

The banking circles make it a rule to plead that the legal duty charged banks to make interest payment returns gives occasion to increased operating expenses, but this pleading does not seem to carry much conviction.

From any point of view, among the recent tax cut plans, nothing is more absurd and unjustifiable than the reduction of the income tax upon interest incomes; a wealthy person who possesses deposits in banks or other financial facilities is required only to pay a flat rate tax of ten per cent upon his interest income, however large they may be. But, on the other hand, a labourer who works overtime is forced to pay income tax at the progressive rate of more than twenty per cent at least, upon his overtime pay, however small it may be, if he earns wages exceeding the total sum of his exemptions, credits for dependency, etc.

Although business circles have not expressed their satisfaction, a relief of about twenty billion yen in favour of business corporations would be a big windfall to them.

Conclusion

A too hasty conclusion would lead us in the wrong direction with respect to the problem: which is the shortest and healthiest road to capital expansion?

- (a) Voluntary saving of individuals resulting in direct investment (purchase of stocks and other equities by savers), or
- (b) Voluntary deposits in banks or other financial facilities other than Government savings agencies resulting in indirect investment (bank loans, purchase of equities and bonds by banks), or

- (c) Accumulation of surplus reserves, etc. in the hands of business concerns (undistributed profits) resulting in re-investment in the same place where capital is accumulated, or
- (d) Acquisition of public funds through taxation, public borrowing, and / or receipts on deposits resulting in Government investment in public enterprise and / or public lending to particular branches of industry, distinguished from sheer spending.

It is true that these four routes to capital formation (saving and investment) are not always in conflict with each other. Route (b) may well be supported by Route (c). Route (c) can be in harmony with Route (d), and so on. But in many cases, Route (d), that is to say, public investment of public funds has an adverse effect upon other routes of capital formation. And we may well maintain that each route, of its own accord, affects somewhat differently the economic development as well as the industrial structure of a country.

Viewed from another angle, this also means that a given state or stage of economic development, and a given structure of industry is apt to give a preference to a particular route.

As was explained elsewhere in this article,¹¹ Japan is a country where government had (and perhaps has) played an important role in investment for many generations, while, on the contrary, individuals have held less bonds, less stocks and less equities. If we dare to arrange the routes of capital expansion according to the degree of importance that each of them has possessed in the economic development of this country, ranking will be first, Route (d), second, Route (c) and (b), and third, Route (a).

As I have indicated repeatedly, the Shoup-Plan attached much importance to Route (a), that is to say, it asserted that capital accumulation was to be attained most normally by way of individuals' saving and individuals' intelligent investment. In reality, the practice of holding stocks has not yet matured among people of this country. In general, those who save their money, prefer to go to the savings account windows of banks or post offices to deposit it. Only restricted circles of wealthy people have used the facilities of stockdealers.

It was due to a large amount of deposits that big banks were able to wield great influence upon business concerns in the pre-war period. Bankers are now doing their best to recover from the great loss of their authority caused by Japan's defeat in the last war.

Route (c), that is to say, accumulation of earnings reserves, etc. seems to be the most favourable means of expanding capital stocks of equipment in that the owners or directors of business concerns can make use of the accumulated reserves at any time and in any way precisely in accordance

¹¹ See above, pp. 20-25.

with their decisions. To-day, when the ratio of investors' capital to creditor' capital is extremely unfavourable to the former, the necessity to increase reserves, in principle, can not be denied. But at the same time, what is noteworthy is that, if a large enterprise of a monopolistic type can enjoy greater concessions in taxation with regard to its accumulated reserves, there will be a greater danger of their being invested in the wrong way.

Much of the recovery of this country has been due to American aid, and to the subsequent fortuitous economic windfall of the war in Korea. Thanks to the greatly increased war procurement demands of more than 790 million dollars in 1952, Japan has compensated for the adverse balance of trade amounting to 430 million dollars, and moreover, has increased her economic activities in every respect.

But this is but a superficial thriving on a flimsy foundation of temporary economic windfall. With the end of the war in Korea virtual realities are now being disclosed. The business circles, while demanding tax cuts in favour of business, and retrenchment of government administrative expenditure, are, at the same time, covetous of another market, whether foreign or domestic, in substitution for procurement demands, and are expecting that the Government will embark on a re-armament programme sooner or later, which will provide a large market for munitions and other war products, and will give munition industries the benefit of public lending.

What is necessary for us is not the expansion of capital equipment that is used only to produce goods no one but the Government purchases, but the formation of capital necessary to produce goods that can either be bought by individual consumers or be exported abroad. If the "endogenous" demand, whether foreign or domestic, is not enough to maintain the production of goods, the industrial structure will be warped. And an undue concession to capital formation would impair the expansion of the endogenous demand.

The recent tax reform tends to adhere to the patterns of capital accumulation which were prevailing before the unconditional surrender of 1945. The Shoup Programme, which was proposed in the hope that Japan, if she so desires, may within a few years have what would be the best tax system in the world, is now undergoing grave modifications, in the name of capital accumulation.

It is extremely difficult for Japan, overpopulated and scant of resources, to accumulate capital without resorting to taxes upon the labouring masses, and to government investment or lending. But one thing is obvious, that we must be cautious enough not to allow "capital accumulation" to become a hypnotic spell potent enough to deprive persons of their due consideration of the other objectives of taxation,

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THE DEVELOPMENT OF MANAGERIAL ACCOUNTING IN JAPAN

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I

The purpose of accounting is to furnish financial data concerning a business enterprise, compiled and presented to meet the needs of a group of people interested in it. The form of presentation and the content, therefore, differs somewhat depending upon to what group the information is to be furnished.

There are many people who are interested in a business enterprise. They can be roughly classified into two groups; outsiders such as investors, shareholders, creditors and tax-authorities and insiders represented by management. In this respect, accounting can be classified roughly into accounting for external reporting and accounting for internal reporting. In the United States, the former is often called financial accounting and the latter managerial accounting.

In the earlier period, a study of accounting for external reporting was more emphasized in the United States and Great Britain. For the past twenty years or so, accounting for internal reporting has also achieved good progress keeping pace with the progress of accounting for external reporting. This trend of progress was not an exception in Japan.

Based principally upon literature and publications, the writer herein attempts to present various arguments raised in Japan regarding managerial accounting, with the aim to trace back the course of development in its theory and practice.

II

The study in Japan of Managerial Accounting Theory dates back to the pre-war period. It was first taken up by a few scholars who specialized in the German school of business economics. They treated it as one component of business economics.

Accountants at that time paid little or no attention to managerial accounting, as their ideas were largely based on public accounting which had developed in the United States and Great Britain. They considered that "accounting aims at the presentation of the balance sheet and profit and

loss statement, and for its purpose, it studies means and procedures by which business transactions can be clearly and accurately recorded".¹

Japan was thrown into depression in 1927. The depression led to the awakening of the necessity of the rationalization of industry and to an awareness of the function of accounting as a tool of management. To cite one or two examples, in 1928, Mr. Yohichi Ueno who acted as efficiency consultant for many years, stressed the need of studying accounting for managerial purposes.² Subsequently, the Financial Management Commission of the Industrial Rationalization Bureau in the Ministry of commerce and Industry started to formulate a "cost accounting guide" in 1930. Despite the most efficient tool of control, the cost system at the time was in an infant stage. The Commission thought that the improvement of the cost system was a pre-requisite to making accounting serve as a tool of control.

In 1933 the Commission published the "Cost Accounting Guide (draft)" and revising the draft, formulated the "Manufacturing Cost Accounting Guide" in 1937. Although these guides dealt with standard cost accounting, they placed more emphasis on historical cost accounting, simply because business enterprises at that time generally adopted this type of cost accounting.

It is true that the improvement of the historical cost system tends to develop the managerial function of accounting. But, historical costs merely show the actual results of past transactions and, therefore, may involve waste which can be economized. The historical cost system for this reason is not a competent tool for current control. With a view to developing the managerial function of accounting, there appeared several scholars who stressed the introduction of future elements. For example, soon after the financial crisis, Prof. Seitaro Suyama, Prof. Rintaro Aoki and the late Prof. Yasubei Hasegawa introduced in succession the ideas of standard cost accounting and budgetary control.

In the industrial field, a few companies having had connection with American corporations started to put into practice the standard cost system. Up to that time the budgetary control system had been fairly well adopted by some organizations, but the tendency for application of the system was further accelerated over wider fields.³

Under these circumstances there appeared some attempts to systematize accounting methods serviceable to management.

As evidence, the late Prof. Yasubei Hasegawa advocated the importance of managerial accounting.⁴ According to him accounting hitherto aimed at

¹ Seijiro Kano, *General Principles of Accounting* (in Japanese), revised edition, 1924. Kinzo Sambe, *General Principles of Accounting* (in Japanese), 1927.

² Yohichi Ueno, *Control of Business Enterprise* (in Japanese), 1928, pp. 39-40.

³ Yasubei Hasegawa, *Research Study of Budget System in our Country* (in Japanese), 1936.

⁴ Yasubei Hasegawa, "Managerial Accounting and Budgetary Control", *Waseda Business Review* (in Japanese), Vol. 8, No. 4/4, 1932, p. 467.

the recording of facts, and for this reason did not serve management control. To make it more useful to management, account must be taken of future elements. Accounting of this nature should be called managerial accounting as contrasted to the former which may be called retrospective accounting. Managerial accounting at the present state consists of budgetary control and standard cost accounting, although some other components may be added to it as time goes on.

The substance of managerial accounting is considered by the late Prof. Hasegawa as perspective accounting for management control. But, to carry out budgetary control and standard cost control, a comparison of either budget or standard costs with actual costs is an absolute requisite. The recording of facts, therefore, is one of the indispensable elements of managerial accounting. As can be seen from business analysis developed in Germany, valuable informations can be obtained by comparing actual costs of different business units. In looking over cash voucher registers, the recording itself serves as a protective device against fraudulent conduct of employees and against inaccuracy, error and omission in cash transactions. The late Prof. Hasegawa was right in stressing the importance of the perspective phase of accounting, but he was wrong in overlooking the importance of recording past transactions to assist management. Prof. Kiyoshi Kurozawa and Prof. Rintaro Aoki are sound on the latter point.

Based on the historical approach, Prof. Kurozawa opines briefly as follow:⁶

“Viewed from the way of approach, there are two kinds of accounting; accounting of public accountants and accounting as a branch of business economics. The former is a set of accounting knowledge requisite to public accountants for the execution of their duties. It must be competent enough to meet the needs of public accountants who represent essentially the interests of outside groups such as shareholders and creditors.

Business economics developed in Germany has two fundamental problems; namely, flow of values and organization problems. Accounting as a part of business economics deals with the former problems; namely, business analysis, business balance sheet, cost accounting and budgetary control. Managerial accounting is a term especially applied to the study of cost accounting and of budgetary control.

Public accountants nowadays may have more chance to work for the outside groups represented by shareholders and creditors. In the earlier period, however, they worked principally for the management of business enterprises. The same is also true in many cases even at present. It is wrong, however, to contrast accounting of public accountants and accounting for management as Prof. Kurozawa did. It is also wrong to assume, as the

⁶ Kiyoshi Kurozawa, *Accounting* (in Japanese), 1933, p. 125 and p. 140.

writer pointed out before, that cost accounting and budgetary control alone and nothing else fall into the category of managerial accounting.

The opinion expressed by Prof. Kurozawa, however, contains two ideas which have induced a further development of managerial accounting. One idea was developed by Prof. Aoki and another by Prof. Furukawa.

In the opinion of Prof. Kurozawa, "Business Analysis" and "Business Balance Sheet" are not to be included in managerial accounting. However, as pointed out before, they undoubtedly function as tools of management control. Thus, Prof. Aoki defined managerial accounting as "a set of accounting knowledge required for management" including therein business analysis and business balance sheet.⁶

The relation between managerial accounting and the so-called "accounting of public accountants" is not thoroughly explained by Prof. Aoki. If we analyse "accounting of public accountants", we see two elements; (1) the accounting procedure and system necessary to the outside group of interests for controlling a business enterprise from outside, (2) the accounting procedure and system necessary to a business enterprise for the purpose of furnishing financial data on behalf of the outside group. These two procedures and systems are interrelated and similar in many respects. Nevertheless, they differ in that the groups which adopt accounting procedures and systems are different—they will be either the outside group of interests or the management of a business enterprise. In other words, the former is performed by outsiders and not by a business enterprise, while the latter is to be performed by a business enterprise as in case of managerial accounting. Accordingly, the problem relative to the latter may be studied together with the problem of managerial accounting under the general caption of business accounting. It was Prof. Furukawa who explained this point in a clear-cut way.⁷

Prof. Furukawa explains; "Accounting implies an entirety of numerical orders in a business enterprise, classified from the viewpoints of both accounting purposes and methods". He continues, "Accounting purposes and accounting methods are in intimate relation with each other. Since business accounting is a means to an end, the classification by accounting purposes is basically important. From the point of view of accounting purposes, business accounting can be classified into accounting for financial statements for the benefit of outsiders of business enterprise and managerial accounting for the benefit of business management. Business accounting is essentially internal accounting, and external accounting is merely of secondary importance. Attention may be called to the fact that the classification of internal accounting and external accounting as herein made, is done by accounting

⁶ Rintaro Aoki, *Managerial Accounting* (in Japanese), 1936.

⁷ Eiichi Furukawa, *Accounting Theory of Business Enterprise* (in Japanese), 1st Vol. 1937.

purposes. The accounting methods such as cost accounting and income determination serve sometimes as internal accounting and sometimes as external accounting. In view of the growing importance of accounting for management, new accounting methods only serviceable for management have come to develop.

This new theory advanced by Prof. Furukawa has not been generally accepted by leading scholars at that time.

According to Dr. Sotaro Takase,⁸ "If accounting aims at the study of furnishing financial data necessary for management and other groups interested in a business enterprise, accounting can never be an independent science." "This," he continues, "is merely an applied technique of principle." "Accounting as a branch of commercial science is a systematized knowledge with the balance sheet as its basic form."

Dr. Tetsuzo Ohta says as follows:⁹ The object of accounting research is accounting procedures of a business enterprise. A business enterprise is a social unit which performs production and distribution, rallying within its unit capital and labor. Accounting not only is a means to maintaining and preserving property for an entrepreneur, it must have social significance as well.

As a result of the business revival started from 1932, industry lost the stimulus of rationalization and became nonchalant to managerial accounting.

During the chaotic period during and after World War II, business enterprises lost interest in managerial accounting which had once been a challenging subject. Despite this loss of interest, the government authorities came to realize the need of the rationalization of industry to meet the national emergency. They compiled and made public the "Manufacturing Cost Accounting Rules" which was legally enforced in all branches of manufacturing industry. It was at that time that the former Japanese Army published several guides to standard cost accounting, budgetary control, financial analysis, business analysis and internal auditing. Meanwhile, literature on managerial accounting appeared in periodicals. Despite these guides and literature, the essentials of managerial accounting were scarcely taken into account in business enterprise.

III

Soon after World war II, Japan faced many knotty problems such as the democratization of investment, inducement of foreign capital and tax-reform. To find a solution for these, the necessity of a reform of accounting

⁸ Sotaro Takase, *Accounting* (in Japanese), 1929, p.32.

⁹ Tetsuzo Ohta, "New Departure for the Study of Accounting," *Economic and Business Review* (in Japanese), No. 5, 1933.

system was keenly felt by those concerned. Subsequently, the authorities promulgated several accounting standards such as "Business Accounting Principles" and "Working Rules for the Preparation of Financial Statements" in 1949, "Tentative Statements of Auditing Standards and Auditing Procedures" in 1950, "Rules for Verification of Financial Statements" and "Procedural Instructions" in 1951.

These served to accelerate the general interest in accounting, especially in accounting for external reporting. Nevertheless, the prosperous business conditions due to the inflationary economic policy of the government tended to retard the progress of rationalization in business and industry. There were very few people who really paid keen attention to managerial accounting. Mr. Joseph Dodge in March, 1949 brought the inflationary policy to a halt.

To attain economic stabilization, utmost efforts were necessary for the rationalization of enterprises. Accounting as a help to management again came to attract keen interest.

I. Several books were published to introduce in Japan the theory of "business analysis" of the German school and the analysis of financial statements of the American school.¹⁰

These publications were a natural consequence of the improvements on preparation and publicity of financial statements and of the general adoption of the historical cost accounting systems based on the "Manufacturing Cost Accounting Rules" established during the war. As "business analysis" and the analysis of financial statements herein discussed constituted essentially managerial accounting based on past records, there were difficulties in using them as a management tool. The standard cost accounting system was proposed to meet the difficulties.

II. The first attempt to introduce standard cost accounting was made by Prof. Rokuro Yamabe¹¹ and then by the writer.¹² The former emphasizes the importance of basic standard cost accounting, while the latter stresses current standard cost accounting. Prof. Yamabe emphasized basic standard cost accounting because he wrote his book at the end of the inflationary period, while the writer's book was published at the beginning of stabilization. In line with the progress of stabilization, there appeared more and more people who upheld current standard cost accounting. In the stabilization period cost standards could easily be set up and theoretically complete control and follow-up is possible only in current standard cost accounting and not in basic standard cost accounting.

Comparing the theory of standard cost accounting before the war with

¹⁰ Masao Matsumoto, *Business Analysis* (in Japanese), 1948. Eiichi Furukawa, *Business Analysis* (in Japanese), 1949.

¹¹ Rokuro Yamabe, *Standard Cost Accounting* (in Japanese), 1949.

¹² Masao Matsumoto, *Standard Cost Accounting* (in Japanese), 1949.

that after the war, there are some characteristic differences. In the prewar period, the setting of cost standards and standard cost accounting were indiscriminately treated, but after the war they were clearly differentiated. The setting of cost standards is merely perspective accounting, while standard cost accounting includes not only perspective accounting but also the ascertainment of actual costs, a comparison of actual costs with standard costs and cost variance analysis. Another characteristic difference is that before the war the setting of cost standards and cost variance analysis were emphasized in the theory of standard cost accounting. After the war, the ascertainment of actual costs has also been considered important same as the comparison of actual costs with standard costs and cost variance analysis.

Thus, standard cost accounting has come to be widely accepted in academic circles as a tool of control. Yet, businessmen were generally apprehensive of applying the system to practical use.

The reasons for this apprehension were:

1. The tax-law at that time was based on historical costs. Hence, if a company adopted a standard cost system, it would have to make a year-end adjustment. There was no short-cut method legally accepted for such adjustment and local tax officers frequently pressed companies to make rigid year-end adjustments. The companies considered it more profitable to adopt the actual cost system which took into account estimated costs, rather than making year-end adjustments.

2. Japanese industry largely depends upon export and hence tends to operate on the basis of job-order production. This leaves Japanese companies far behind in the standardization of production processes. Most factories in Japan find it extremely difficult to estimate reliable current standard costs.

3. In order that the standard cost accounting system can be most effectively used for management control, the function of cost accounting should be thoroughly understood by executives and superintendents who use this control tool as well as by workers who are to be controlled by it. In Japan at that time, neither executives, superintendents nor workers understood this function well.

Circumstanced as they were, even if standard cost accounting had been put into practice, it would hardly have been as effective in Japan as in the United States. This system, therefore, was only studied for application by a few mass-production plants which were comparatively advanced in time and motion studies.

III. Time was ripe for the revival of budgetary control. As mentioned previously, budgetary control which had been fairly well popularized all over Japan, went out of use in the chaotic period during and after the war. With the progress of deflationary economic policies, business and industrial circles were thrown into financial difficulties. To meet them, they instituted

a budgetary control system, especially a cash budget. However, most emphasis was laid on the restriction of cash outlays which had much in common with the government budget system.¹³

IV. The discussion of managerial accounting became very active among scholars as well.

The first feature of the managerial accounting theory at that time was the new views advanced by scholars on the classification of managerial accounting. Formerly, classification based on accounting methods was popular. For example, Dr. Hasegawa classified managerial accounting into standard cost accounting and budgetary control.¹⁴ Prof. Furukawa, on the other hand, classified it into budget, short-term bookkeeping, historical cost accounting (partial costing), standard cost accounting (predetermined cost accounting), efficiency measurement, business analysis and business statistics.¹⁵

It was Prof. Kazuo Mizoguchi who first raised objection to the above classifications.¹⁶ In his opinion, managerial accounting does not imply any specific accounting method, but consists of any accounting method which will be serviceable as a tool of management. The managerial accounting system and technique, therefore, should be viewed from the field to which they are applied. In other words, managerial accounting should be treated as managerial accounting in various fields such as finance, procurement, production and sale.

As managerial accounting is one type of accounting, it should be embodied in accounting methods. The methods of controlling business through managerial accounting vary, depending upon business processes such as procurement, production and sale. Managerial accounting, therefore, may be classified based both on accounting methods and business processes. As generally accepted, managerial accounting is accounting which serves the management of a business enterprise and as such, should be classified by management processes. Viewed from these processes, management may be roughly classified into planning and control. Planning may further be subdivided into individual planning and general planning, and control into divisional control and general control. These sub-divisions are integral parts of management organically bound together. They have separate and different functions and accounting for each should be different. From this point of view, managerial accounting, the writer proposes,¹⁷ may be divided into accounting for planning and accounting for control. Accounting for planning may further be sub-divided into accounting for individual planning and accounting for general planning (budgeting); accounting for control into

¹³ Eiichi Furukawa, "Application of Internal Control to Japanese Industry", *Management Review* (in Japanese), Vol. 7, No.1, p.20, 1953.

¹⁴ Yasubei Hasegawa, *op. cit.*, p. 466.

¹⁵ Eiichi Furukawa, *op. cit.*, p. 102.

¹⁶ Kazuo Mizoguchi, *Managerial Accounting*, (in Japanese), 1950, p.27, p.29.

¹⁷ Masao Matsumoto, *Cost Control* (in Japanese), ed. by M. Matsumoto, 1953, pp.17-18.

budgetary control and divisional control.

The second feature of managerial accounting at that time was emphasis placed on the close tie-up of managerial accounting with management organization for effective operation. To cite an example, Prof. Furukawa stressed as follows: "Managerial accounting, viewed from the accounting system, is one integrated whole of the accounting methods serviceable to all levels of management". But, the following facts should be taken into consideration: firstly, management accounting is based on the management process, secondly, management accounting is in inseparable relation with management organization. We, therefore, have to tackle with two problems:

(1) Organization problems of the line departments which are directly managed through managerial accounting.

(2) Organization Problem of the staff departments which put managerial accounting into operation.¹⁸

The same opinion was expressed in a different form in July, 1951, when the Financial Management Commission, the Council on Industrial Rationalization attached to the Ministry of International Trade and Industry published a draft entitled "Outline of Internal Control in Business Enterprises". In this draft the Commission proposed;

(1) To realize the vital necessity of rationalizing enterprises, internal control based on accounting control shall be thoroughly enforced.

(2) To make internal control effective in operation, an independent comptroller's department in charge of this function shall be established in the staff department. The comptroller shall be responsible for its operation.

The internal control mentioned signifies that through accounting methods management from over-all observation of an enterprise conducts planning of line activities based on the highest policy, coordinates operations and appraises performance. Internal control is one form of management, but it is indirect management through accounting figures different from process control or quality control which is directly connected with business operations.

To express it more concretely, internal control implies not only budgetary control, standard cost accounting and internal auditing but also accounting method and systems used for management such as statistics, general accounting and historical cost accounting serviceable for its performance. Internal control herein implied, does not conform to the auditing terminology commonly used in the United States. It is rather synonymous with managerial accounting above discussed. The new feature in the "Outline of Internal Control" is that managerial accounting is treated in relation with the comptroller's department in charge of its functions.

In this connection, Prof. Yasuichi Sakamoto says as follows:¹⁹

¹⁸ Eiichi Furukawa, "The New Development of Managerial Accounting", *Departmental Managerial Accounting* (in Japanese), 1953.

¹⁹ Yasuichi Sakamoto, "Problems of Managerial Accounting", *Financial and Cost Accounting* (in Japanese), Vol. 11, No. 6, 1951, p.34.

"Accounting essentially aims at the presentation of supplementary data for management control. When this be accepted, managerial accounting is directly conscious of the functions of accounting itself. Managerial accounting, if it deals with methods for direct control of business activities, will go beyond the intrinsic field of accounting, thereby trespassing a field of study on behavior and results of business operations through accounting methods."

"In many studies on managerial accounting nowadays, the terms of internal control and managerial accounting seem to be used in confusion. Discussion concerning the comptroller's department, it seems to me, is actually a debate on management organization. It does not belong to the intrinsic field of accounting. It is the problem which constitutes a premise for managerial accounting, but it should not be considered as study of component parts of managerial accounting".

As Prof. Sakamoto rightly said, managerial accounting is not executive control itself by means of accounting methods, but "is accounting for management".

Prof. Sakamoto goes on to say: "After all, accounting aims at the presentation of data for management control. It serves management directly and indirectly. When a company makes up its financial statements through accounting methods on behalf of stockholders and creditors, accounting is of service to management control indirectly and to outside interests directly. When management intends to elicit data for management planning and control by means of accounting methods, accounting proves of service to management directly. Managerial accounting is the accounting which is conscious of such a direct service to management."

Prof. Iwao Iwata seems to have the same opinion of managerial accounting as Prof. Sakamoto, although he expresses it in quite a different way.²⁰

According to Prof. Iwata, accounting is for accounting control of a business enterprise. Accounting control signifies accountability by means of recording the flow of assets on accounting-books to safeguards assets in business and increase the efficiency of management. "When a particular department or a person within an organization of responsibility is authorized to receive, store and issue assets and the responsibility thereof is limited to the area delegated, that department or the person in charge shall be responsible for explaining upon request the details as to how the assets entrusted have been received, stored and issued. Accountability here signifies such a responsibility". Accounting control is exercised either from the management's standpoint over the internal organization of an enterprise or from the investor's standpoint over the business enterprise. If there exists a kind of accounting which could be called accounting for management

²⁰ Iwao Iwata, "Account, Accountability and Accounting Control", *Financial and Cost Accounting* (in Japanese), Vol. 13, No. 1, 1953.

it shall be classified into accounting for internal control used as "a tool of management" and accounting for external control used as "a tool of enterprise control". If this is what Prof. Iwata really means, then "internal managerial accounting" advocated by him corresponds to "managerial accounting" as defined by Prof. Sakamoto and "accounting for internal reporting" as defined by the writer. Prof. Iwata's "external managerial accounting", on the other hand, corresponds to Prof. Sakamoto's "indirect managerial accounting" and the writer's "accounting for external reporting". As accounting for internal reporting must be differentiated from direct control through accounting figures, accounting for external reporting must be differentiated from enterprise control by outsiders by means of financial statements or tax-returns.

The third feature of managerial accounting is the clarification of relations between "accounting for internal reporting" and "accounting for external reporting".

It is now recognized among influential scholars that accounting of a business enterprise has two-fold functions. It serves outside interests for the control of an enterprise and also serves management for internal control. These two functions were not quite unknown before. What the writer wishes to emphasize here is that formerly, accountants placed more emphasis on external reporting rather than on internal reporting. They now emphasize both, and sometimes lay more importance on internal reporting. This brings to light two discoveries:

The first discovery is that accounting procedures which serve the purposes of internal and external reporting have something in common but also different. The difference in detail of internal and external reporting should be clarified. This is one problem of managerial accounting with which we are now confronted in this country.

The second discovery is that accounting procedures of both internal and external reporting, when carried out continuously in a business enterprise, should be combined for higher efficiency, as they are both performed in the same enterprise.

The fourth feature is that the preparation of management reports has come to be considered as important as the preparation of financial statements.

As repeated before, it is now generally recognized that managerial accounting is accounting procedure on behalf of management. Formerly, the ascertainment of accounting facts serviceable to management was emphasized and the method of communicating the facts to management was treated lightly. Now, it is known that only management and nobody else can manage business and that managerial accounting is merely a tool of management. As a result, the study of accounting reports—the media through which accountants inform management of the result of their findings—has come to be considered important. No matter what useful figures accountants

may prepare for management planning and control, they are just futile unless they are made known to management and well understood.

In connection with accounting reports, it is now being discussed as to whether or not the following items belong to managerial accounting: a technician informs a cost department of physical standards which he has decided; a factory superintendent, basing himself on cost reports compiled by a cost department, studies the causes of cost variances and informs the cost department of the result of his findings. Although there are many controvercial opinions as to these questions, many scholars do not consider them as part of managerial accounting. The reason adovanced, is that "valuation" is the fundamental convention on which modern accounting is based. Nevertheless, it is beyond doubt that the development of managerial accounting is gradually modifying the traditional idea formerly entertained by many scholars.

IV

As described in the preceding section, "Outline of Internal Control" involves many controversies, but the idea embodied in it reflects the practical needs of business enterprises in this country. This report proved a turning-point for a number of companies by inducing them to put managerial accounting to practical use. It paved the way to the practice of managerial accounting by introducing comptrollership in their organizations, and they started preparations for standardization of operation processes, clear-cut delineation of management organization and improvement of reporting systems.

It should be noted that along with these developments, the active exchange of views among businessmen prompted managerial accounting to be put into actual use. At present, the exchange of views is conducted in the following manner: several groups are organized among a number of industrial companies for research and discussion. They are mainly composed of businessmen who bring up for discussion various problems relative to managerial accounting. In addition, businessmen of leading companies published articles in periodicals based on their own experience in daily transactions. This exchange of views furnishes valuable data for the promotion of knowledge and has already proved a driving force to convert "imported managerial accounting" into "home-bred managerial accounting". Appreciating the usefulness of managerial accounting, some Japanese companies have already adopted the system into their organizations. But, the majority do not yet understand the system well. To make these backward companies aware of the usefulness of this system, the establishment of procedural standards is keenly hoped for.

To meet the timely need, the Financial Management Commission drafted

a report entitled "Outline of Procedures for Internal Control" in February 1953 and submitted it to the Council on Industrial Rationalization for publication. This report clarifies the relations between the Comptroller's Department, the Treasurer's Department and the Board of Executive Officers and exemplifies the outline of procedures relative to budgetary control, statistics, economic research and internal auditing.

In connection with this report, the following problems are now under consideration.

The first problem originates in the fact that the procedures described in the "Outline" are the procedures of managerial accounting for top-management which place emphasis on budgetary control and internal auditing.

Top-management levels in this country have generally managed their companies by "the rule of thumb". Such management undoubtedly delays the sound progress of managerial accounting of Japanese companies. After the war, there appeared two factors which gave an impetus to the top-management organization to adopt managerial accounting. The first factor is that as a business enterprise expands to a larger scale, the necessity is keenly felt for accounting which will assist top-management. The second factor is that the purge of old directors from industry and business soon after war, afforded a good chance to young and progressive college graduates to be promoted to top-management level. It was an opportune time for managerial accounting standards serviceable to top-management.

Managerial accounting for departmental control should be equally taken into account as an important factor in management. Cost accounting plays an important role in departmental control. The cost system prevailing in Japan under the influence of the system established during the war, which primarily aimed at price-fixing, is weak in performing control functions. Moreover, on account of the existing regulations of the tax-law, the standard cost system is not easily put into practice as explained in the preceding section. As departmental control accounting is found more important, business keenly feel the necessity of guidance which may help to improve their cost accounting system. With regard to the relation between budgetary control and standard cost control, the "Outline of Procedures for Internal Control" gives them little or no guidance, merely saying that "standard cost control is exercised primarily in factories under supervision of the comptroller's department". It is a matter for congratulation that the keen necessity for guidance to cost accounting is about to be fulfilled by a report on "Cost Accounting Standards" which has been in the process of drafting for the past several years by the 4th Sub-Committee: Matters concerning Cost Accounting Standards of the Business Accounting Council attached to the Ministry of Finance.

Attention may be called to the instruction issued in June, 1953 by the Bureau of Internal Revenue in connection with the disposal of cost variance. Although this instruction still backs up the historical cost basis, it authorizes a

short-cut method of cost-variance-adjustments. This instruction has not been well received by those who look upon current standard cost system. Nevertheless, the instruction is a step forward to the improvement of standard cost accounting in the sense that the inconsistencies and rigidity on the part of local tax authorities in cost-variance-adjustments have been somewhat moderated.

According to the explanation given by the tax authorities, the cost-variance-adjustment method suggested in the instruction is only a temporary measure. As soon as the "Cost Accounting Standards" is put into force, the tax authorities are likely to comply with that standards. It is expected that cost accounting for management will show a striking progress upon the promulgation of the "Cost Accounting Standards".

The second problem originates in the fact that the "Outline of Procedures for Internal Control" stresses the importance of the profit control function of budgetary control and the managerial function of internal auditing.

As shown in the preceding section, budgetary control has been widely adopted by Japanese companies. But it emphasizes cash budget. The "Outline", however, stresses the importance of budgetary control as a tool of profit control in the same extent as or even more extent than cash budget. This view is becoming more and more popular among businessmen.

An even more important point than budgetary control is that the "Outline" looks upon internal auditing as a supplement to various tools of management.

Before the war, internal auditing was adopted only by a few companies. Since the war-end, it has been attracting keen interest in industrial and business circles, chiefly because the system must be established that may assist public accountants in financial auditing. The essential function of internal auditing, however, is not to assist public accountants. It is a type of control by which the efficiency of other control methods is measured and evaluated. Internal auditing serves public accountants as a derivative of its essential function. The function of internal auditing as a tool of management, since the "Outline" stressed its importance, has come to be generally accepted in Japan.

The third problem to be pointed out is that the "Outline" does not explain in detail the procedure of planning. Planning is the selection of the most profitable out of many ways of activities in a business enterprise. The plan selected indicates a goal toward which the enterprise should go forward and by which its activities are to be controlled.

Once a plan is inappropriately established, a business enterprise cannot achieve success, no matter how well controlled. Planning, therefore, is the most important process of management.

Plans may be formulated either based on figures or through intuition. In the modern enterprise on a large scale, plans are formulated more or

less on some numerical data. For this reason, accounting for planning is essential as a component part of managerial accounting. Plans are made of general operations of a business enterprise or of individual operations. Accordingly, there are two types of accounting which serves for general and individual planning. The formulation of budget belongs to the former and the selection of factory sites and the selection of production methods and selling prices to the latter.

The "Outline" differentiates planning from internal control the same as the writer does. Nevertheless, the "Outline" explains the formulation of the budget in minute detail.

Budgeting as part of planning and budgetary control as part of internal control are very closely related. Because of this close relation, it might have been convenient for the Commission to incorporate both in the "Outline". Nevertheless, the "Outline" does not explain clearly the reason why they are treated together. In the writer's opinion, this is a weak point of the "Outline".

When cost accounting of the German school was introduced in Japan more than a decade ago, accounting for individual planning was studied as a useful means for establishing a capacity-utilizing and pricing policy.²¹ This accounting method was not widely accepted in business circles at that time. There are many reasons for this. One important reason was the fact that Japanese industry is strongly influenced by politics, diplomacy and market conditions abroad. The influence of these factors can hardly be measured by figures. As a result, management at that time had little or no appreciation of accounting as a help for planning. Since then, conditions underlying Japanese enterprise have not undergone much change, except that the top-management was largely purged after the war. The new management seems to be more inclined to use accounting data in planning. It is reported that accounting as a help to planning is attracting interest in the United States. In response to this, such a type of accounting is also attracting interest in Japan as a means of management. The upsurge of interest in special cost studies, profit chart and break-even point as now seen in recent publications and periodicals, serve to indicate a new trend in Japanese business accounting.

In view of the above, the Financial Management Commission selected the topic, "Procedures for Planning", as a subject of study for this year and is now drafting a report.

The Korean truce has seriously affected Japanese industry which is largely dependent on special procurement for the U. N. Forces. In order to overcome the difficulties, Japanese industry must exert its utmost for the rationalization of enterprise. The time is ripe for managerial accounting to be widely accepted in the industrial and business circles of this country.

²¹ Akira Yamashiro, *Theory of Business Cost* (in Japanese), 1936., Otojiro Kubota, *Theory of Cost Components* (in Japanese), 1938.

JAPAN'S RECEPTION OF THE LAW OF NATIONS

ZENGO ŌHIRA

By Professor of International Law

I. *Opening of Japanese Ports and the Law of Nations*¹

Japan's renunciation of her traditional isolation, opening her ports to the European and American nations and making herself a member of the Family of Nations, is regarded as the result of the expedition commanded by Commodore Matthew Perry. The present year (1953) being the centenary of the Commodore's visit to Uraga, gala celebrations were held in this country in commemoration of the event.

In July, 1853, Perry, with his four ships-of-war, left Napha and arrived at Uraga, where he demanded the opening of the country to foreign intercourse. The letter of President Millard Fillmore addressed to the Emperor of Japan, which document the Commodore carried with him ("Public letter of Millard Fillmore, President of the United States of America, to His Imperial Majesty the Emperor of Japan"), was delivered July 14 (Thursday) on the shore of Uraga to Toda Izumo-no-Kami and Ito Iwami-no-Kami, who represented the Japanese Tycoon. In his letter dated November 13, 1852, President Fillmore stated the aims of the expedition in the following terms:—

"These are the only objects for which I have sent Commodore Perry, with a powerful squadron, to pay a visit to your Imperial Majesty's renowned city of Yedo: friendship, commerce, a supply of coal and provisions, and protection for our shipwrecked people."

That the Shogunate Government received the American state document at Uraga was itself an anomaly, but by amending the ancient law, Japan signed a Treaty of Peace and Amity between the Empire of Japan and the United States of America at Kanagawa on March 31 the following year. This Kanagawa Treaty, which heralded the opening of the country, was a brief document of twelve Articles, but laid the foundations for friendly intercourse between Japan and the United States, which continued over a

¹ The following are the author's Japanese language articles on this subject: *The Reception of the Science of the Law of Nations* in the Takushoku Ronshu, Vol. 7, Number 1, (1936); *The Reception of the Science of International Law and the Theory of the Law of Nature* in the Hitotsubashi Ronso, Vol. 2, Number 4, (1938); *Three Phases in the Opening of the Country* in The Problems of Contemporary Jurisprudence published by the Hitotsubashi University (1952).

century. The First Article of the treaty was a great declaration of the ideal and aspiration:

"There shall be a perfect, permanent and universal peace, and a sincere and cordial amity between the Empire of Japan on the one part, and the United States of America on the other part, and between their people respectively, without exception of persons or places."

The Kanagawa Treaty led to the agreements with Britain and Russia. On October 14, 1854, a convention between Japan and Britain (Sterling's convention) was signed at Nagasaki, while on February 7, 1855, a treaty between Japan and Russia (Poutiatine's treaty) was concluded at Shimoda. Poutiatine's treaty belonged, in respect of wording, to the same category as the compacts with the United States and Britain; but what was interesting about the treaty was, that in Article 2 it settled the boundary between Japan and Russia in regard to the Kuriles, giving to Japan the island of Etoroep and to Russia the Kuriles north of the island. But the treaty made no division of Saghalien, but treated it as a condominium. However, in a treaty signed May 7, 1875, between Japan and Russia (*Traité d'échange de l'île de Sakhaline et du groupe des îles Kouriles entre le Japon et la Russie*), Japan secured to herself, in exchange for her rights in Saghalien, the whole group of islands including Choumcheu at the northern tip of the insular chain. This historical fact is here referred to because of its extreme importance in interpreting the territorial clauses of the Peace Treaty with Japan signed in September 8, 1951.

By the visit of Commodore Perry, Japan was enabled to conclude the Kanagawa treaty. Under this treaty, however, Japan opened only three ports (Hakodate, Shimoda, and Nagasaki), recognizing them as ports of call where the ship's fuel-wood, water and food could be procured; but general commerce was by no means permitted, to say nothing of the mutual visit of traders. It remained for Townsend Harris, who next appeared on the scene, to open the country to foreign trade in general.

On August 4, 1855, the United States Government appointed Harris Consul-General and Diplomatic Representative in Japan, and gave him full powers to negotiate a commercial treaty with Japan. In August next year, Harris arrived at Shimoda on board the *San Jacinto*, where, on September 4, he had the first consular flag of the United States hoisted at the Temple Gyokusenji.

Harris insisted that, in the Law of Nations, a Diplomatic Envoy was entitled to visit, and reside in, the capital of the receiving State. Entering Yedo toward the end of November, 1857, he succeeded in obtaining an interview with the Shogun on December 6, and explaining the world situation, he urged the need of a commercial treaty. In dealing with this country, Perry had shown a dignified front, as he had the naval power as his background; whereas the method of Harris was that of patient but eloquent

pleading on the needs and customs of international society. In a speech which he delivered on December 12, 1857, at the residence of Hotta Bicchu-no-Kami, Harris started from the invention of steamships and described how international trade came to flourish and asserted that it was now impossible for Japan to maintain the exclusion policy any longer. He added that the three great points would be: 1st, the reception of foreign ministers to reside at Yedo; 2nd, the freedom of trade with the Japanese without the interference of Government officers; 3rd, the opening of additional harbors.

In demanding the residence of himself, as a diplomatic representative, in Yedo and foreign trade, Harris referred frequently to the Law of Nations as the ground for his demand. To the Japanese, the Law of Nations even as a term was something new. On the ground of the Law of Nations, he insisted upon the franchise de l'hôtel and demanded the withdrawal of the police surveillance to which he was subjected. Upholding the extraterritorial privileges of the diplomatic envoy, he allowed himself to walk freely in the street. He protested against the refusal of local people to supply the envoy with articles for his use, declaring that it would be a violation of the treaty to do so.² At the same time, he did not forget to exert a psychological pressure on the Japanese authorities, pointing to the China situation which had arisen in consequence of the Arrow affair. T. H. Donker Curtius, the Netherlands Consul in Nagasaki, informed the Shogunate of the Anglo-Chinese imbroglio, pointing up the advisability of concluding a commercial treaty between Japan and the Netherlands—a treaty favourable to Japan. Thus, on October 16, 1857, a supplemental treaty (Additionele Artikelen, over-eengekomen tusschen de Nederlandsche en Japansche Gevolmagtigten) was signed at Nagasaki.³ This was the first commercial treaty ever signed by Japan with a foreign Power. But then Japan had been trading for long with the Netherlands at Nagasaki, and the treaty meant by no means the adoption by Japan of the general policy of open ports. Harris' insistence upon the country being opened to foreign trade in conformity with the general principles of international society, therefore, could not only shake the foundations of the old conception of things to which Japan was still adhering.

In diplomatic negotiations, the plenipotentiaries on the other side did not fail to appeal to the Law of Nations. In the negotiations of those days, Dutch and Chinese (particularly the former) were the usual languages used as medium. English was first translated into Dutch and then re-translated into Japanese. For the Japanese delegates, the order was reversed, and the translation was anything but excellent. The delegates on the other

² The Complete Journal of Townsend Harris, First American Consul General and Minister to Japan, published for the Japan Society, New York, 1930, pp. 297, 457.

³ Okuma Shin, *The History of Far Eastern Diplomacy in the Closing Period of the Shogunate*, 1944, Tokyo, p. 74.

side frequently used the term of the Law of Nations, but the Shogunate officers had little knowledge of the system, to say nothing of individual rules of that law. These officers, however, took the general meaning of the term and variously rendered it as 万国普通之法 (Bankoku-futsu-no-hō; common laws of nations), 万国普通之常例 (Bankoku-futsu-no-jōrei; Usual practice of nations), 万国普通之公法 (Bankoku-futsu-no-kōhō; Common public laws of nations), 欧羅巴之法 (Yoroppa-no-hō; Laws of Europe), or 欧羅巴通国之法 (Yoroppa-tsukoku-no-hō; Common laws of European countries). Their understanding of the subject was only rudimentary. However, the traditional culture of the Japanese, especially the knowledge of Chinese classics, stood them in good stead, for they intuitively understood the general tenor of the Law of Nations as 天地之道 (Tenchi-no-michi; Nature of the universe) or 宇内之公道 (Udai-no-kōdō; Public road of the world), which recalled the Confucian theory of 天道 (T'ien-tao; Way of Heaven). The Japanese thought had long been nurtured by Buddhism and Confucianism, and the Shogunate officers revealed the influence of Confucianism, particularly of the school of Chu-tsu (1130-1200). Neo-Confucian Philosophy 朱子学 (Chu-tsu hsüe), otherwise called 宋学 (Sung Study), was a school of Chinese philosophy established by Chou Tung-I (1017-73), developed by Chang Hêng-Ch'ü and the Ch'êng brothers (Ch'êng Ming-Tao and Ch'êng-I-Ch'uan), and completed by Chu-tsu. This school, which emphasized reason and order, was the natural law school of the Orient. The doctrine of Chu-tsu was recognized by Tokugawa Ieyasu (1542-1616) as the official philosophy of the Shogunate and the advisers to the Shogunate administration were chosen from among the followers of this school.

There is no existent record showing that the foreign negotiators were anxious enough to see how the Japanese accepted the term of the Law of Nations which they were so fond of using. Upon an interrogation, Harris had a long and unpleasant debate about his diplomatic rights.⁴ Meanwhile the Japanese were preparing their minds, in order to revise the traditional policy of exclusion and to adopt the policy of open ports; further, they were learning how to make use of the Law of Nations in their domestic relations, in order to overcome opposition. If the open port policy was what the public road of the world required, there would be no ground for the followers of Confucianism to refuse any longer the opening of the country to foreign intercourse.

A pioneer diplomat of Japan, Hotta Bicchu-no-Kami Masayoshi (1810-64) who acted as host to Harris, had learned a conception of the Law of Nations before the Envoy came up to Yedo, from the letters which he received from Shimoda. In the spring of 1855, he took up the pen and wrote refuting the obstinate officials and asserted that mutual trade was the

⁴ The Complete Journal of Townsend Harris, *op. cit.*, pp. 487, 491.

common law of nations. He sought the excuse for the opening of the country in the Law of Nations, and frankly admitted that it was now inevitable to revise the exclusion policy. Regarding the request of Harris to come up to Yedo, Hotta refused to listen to the bigoted opponents, and in the face of the majority who were still in the old rut, he advised the Shogun, Tokugawa Iesada, in favour of the new policy. Obtaining the permission of the Shogun for the presentation by Harris of the state document, for his visit to Yedo, and for his attendance at the Castle, Hotta had the proclamation issued, declaring that Harris would now be received in Yedo. This proclamation of August 28, 1854, not only recalled the precedent prior to the Exclusion Ordinances (1635 and 1639) of the Kan'ei era, but it had the usual practice of nations for its ground. Ii Kamon-no-Kami Naosuke (1815-69), a strong proponent of amity and commerce with the United States of America, had presented in 1853 a memorial, in which he argued that it was the way of heaven and earth to minister to each other's needs in trade.

The Shogunate authorities began the effort for the study of the Law of Nations in order to meet the need of diplomatic negotiations with foreign countries but also for the furtherance of the new policy. Being believers in Confucianism, they interpreted the naturalistic character of the Law of Nations in an Oriental manner, treating it as a panacea for the policy of opening the country to foreign intercourse and commerce.

II. Beginning of the Study of the Law of Nations in Japan

The first Japanese who made a study of the Law of Nations in the institutions of the Netherlands were Nishi Shūsuke (later Amane, 1826-94), Tsuda Shinichirō (later Masamichi, 1829-1903), Enomoto Kamajirō (later Takeaki, 1836-1908), etc. In 1862, the Shogunate Government, while placing the order of a warship with the Netherlands, sent at the same time a group of students, 15 in number, to that country, Uchida Tsunejiro (later Masao) acting as the leader of the group. Leaving Japan in June, 1862, and going by way of the Cape of Good Hope, they arrived at Rotterdam in April the next year. After acquiring knowledge and technics in their several fields, they returned home to contribute to the development of Japanese culture in their respective spheres.

At the university of Leyden, Nishi Shusuke and Tsuda Shinichiro studied Jurisprudence, the Law of Nations, and Constitutional Law under the personal guidance of Prof. S. Vissering. Returning to Japan earlier than the others, they both served the Shogunate, Nishi lecturing on the law of nations, and Tsuda on constitutional law. Later their lectures were edited and published. These works were well known Nishi's 万国公法 (Bankoku-kōhō;

Law of Nations) and Tsuda's 泰西国法論 (Taisei-koku-hō ron; Constitutional laws of Western Countries). Nishi's book was in four volumes printed from wood-blocks.

Enomoto Kamaji, assistant leader of the group, who studied naval matters, received instruction from Frederich, a Dutch professor, in the *Règles internationales et Diplomatie de la Mer* written by the French savant, Jean Félicité Théodore Ortolan (1808-74). He came home in 1867 on board the warship *Kaiyō-maru* built in a dockyard at Dordrecht, and made use of his knowledge of maritime international law on various occasions as assistant commander of the Shogunate navy. When he made his escape to Hakodate, he notified the Ministers of different countries and asked for the recognition of his force as a belligerent body, and planned the first colonization of Hokkaido in order to fulfil the conditions of belligerency.⁵ Enomoto was later appointed Vice-Admiral. In 1874, he became the Japanese Minister to Petersburg and signed the Treaty of Exchange of Saghalien and the Kurile Islands. In 1888, Ortolan's book on Maritime International Law, *livre troisième, état de guerre*, appeared in Japanese translation at the hands of the Japanese navy.

In 1865, with a view to establishing iron-works in Yokosuka, Shibata Hyuga-no-Kami, magistrate for foreign affairs, was dispatched to Great Britain and France as special commissioner. Fukuchi Genichiro (later Ōchi), 1841-1906, a member of the suite, had received an informal order to study the Law of Nations, but he failed to complete his studies on account of his inadequacy in the knowledge of French and other circumstances. Already in 1861, Fukuchi had joined the mission of Takenouchi Shimoosa-no-Kami, Matsudaira Iwami-no-Kami, and Kyogoku Noto-no-Kami, which was dispatched to the six countries of Great Britain, France, Russia, Holland, Prussia, and Portugal in order to negotiate a delay in the opening of treaty ports. Fukuzawa Yukichi (1834-1901), a prominent scholar of the Japanese Enlightenment, he it remarked, had also joined the mission. For Fukuchi, the visit of 1865 was his second one; it is presumed that he had enough opportunity to study the conditions of foreign countries. During this visit, he was interested in the newspapers. He came later to preside over the Tokyo *Nichi Nichi Shimbun*, but it was during this period that he had laid the foundations to become a well known writer. In 1869, Fukuchi translated from Hudson's English version the *Guide diplomatique ou Précis des droits et des fonctions des agents diplomatiques et consulaires*, 1832, written by the German author Baron Charles de Martens (1790-1863), and published the translation under the title of 外国交際公法 (Gaikoku-kosai-kōhō), in two volumes which were bound in Japanese style. This may be regarded as a by-product of his foreign visits. This *Guide diplomatique* was

⁵ Osatake Takeshi, *the Story of Diplomacy in the Closing Period of the Shogunate*, 1930, Tokyo, pp. 3, 378-392.

translated into Chinese by 丁韪良 (Ting Wei-liang otherwise William A. P. Martin, 1827-1916) and published with the title of 星軺指掌 (Hsing yao chih chang).

The science of international law introduced into Japan through Chinese translations exercised a very large influence. The Chinese defeat in the Opium War and the Arrow affair was a serious shock to the Japanese, which event accelerated the opening of Japan to foreign intercourse and the signing of the Harris treaty (1858). After the Opium War, the study of the West was in vogue in China, with many Westerners coming over to that country; as a result, a large number of books on the West appeared, which publications were directly exported to Japan. In 1864, the American missionary above referred to and known as 丁韪良 (Ting Wei-liang) published in Peking in Chinese translation the Elements of International Law of an American author Henry Wheaton, (1785-1848), under the title of 万国公法 (Wan kuo kung fa). In 1850, Martin, or 丁韪良, a Presbyterian preacher, had arrived at Nippon; not only did he become leader of the Christian Church in Peking, but he had a good knowledge of the native language. Commencing the Chinese translation of the Bible, he first published the Gospel of St. John which was fraught with the Logos idea of Greece.⁶ He rendered the first verse "In the beginning was the Word, and the Word was with God, and the Word was Good" as (T'ai ch'u yu tao, tao yü shang ti t'ung tsai, tao chiu shih shang ti) (In the beginning was the Way, Natural Reason, and the Way was with God, and the Way was God.) In 1854, he wrote the Evidences of Christianity, which Burdon translated into Chinese and published in three volumes with the title of 天道溯原 (T'ien tao su yüan).⁷ This was an attempt to prove the Gospel and Christianity in a manner consonant with the Oriental thought of Heaven and the Way. The Chinese version of the book was read with admiration in China, and in May, 1886, it was translated into Japanese by Nakamura Masanao (1832-91) and published in Yokohama, to exercise a useful influence in Japan.

Martin became president of the Tung Wen Kuan, Peking University, and did his best in the training of the Foreign Office (Tsungli Yamen) officials. Besides the translation of Wheaton, he also translated into Chinese works of Theodore Dwight Woolsey (1801-89) and Johann Kaspar Bluntschli (1808-81). Woolsey's Introduction to the Study of International Law, first published in New York, 1860, appeared in Chinese translation in 1877 under the title of 公法便覽 (Kung fa pien lan). Bluntschli's Das moderne Völkerrecht, published in 1868, was translated by Martin from M. C. Lardy's French version. This Chinese translation was published in Peking in 1880 with the title of 公法会通 (Kung fa hui tung). Imported into Japan, the

⁶ K. S. Latourette, *A History of Christian Missions in China*, New York, 1929, p. 430.

⁷ Latourette, *op. cit.*, p. 433. *China Mission Hand-Book*, Part 2, p. 40.

latter book was translated into Japanese by Kishida Ginko in 1881.⁸

Martin rendered the Law of Nations as 万国公法 (Wan kuo kung fa) or simply as 公法 (Kung fa); his attempt to link up the Oriental thought of Heaven or the thought of Natural Reason with the Occidental idea of the Natural Law, making it easier to introduce into the Orient the Occidental thought and institutions, must be highly appreciated. Martin, who lived for many years in China and was conversant with the Oriental modes of thought, not only made use of the theory of T'ien Tao in the propagation of Christianity, but seems to have utilized the knowledge of the theory in the explanation of the Law of Nations. He did this not merely as a matter of convenience but was himself an adherent, it is presumed, of the Natural Law school. But when we compare his translations with the original texts, it is seen that the ideas of the Natural Law are more prominent than in the original. He stated that the sources of the Law of Nations are in the Natural Law, asserting the identity of the Natural Law and Law of Nations. By using discretion in his translations, he attempted to introduce to the Orient, it must be said, the theory of the Law of Nations strongly tinged with the Natural Law.

Wheaton's *Elements of International Law* in Martin's Chinese translation was imported into Japan in the following year and was reproduced in Tokyo by the Kaiseijo, the university of the Tokugawa Government. The intellectual class of those days consisted very largely of the scholars of Chinese classics, and those who were able to read Western writings in the original were few and far to seek. The intellectuals, therefore, vied with one another in reading Martin's translation, and this exercised an extremely large influence in the formation of the new orientation. This book, which was later reproduced in various places, and also translated into Japanese, was regarded as possessing the authority of a Bible. In 1868, that is, Tsutsumi Koshiji translated it into Japanese. His translation, which was easy to read, ended with Book II, Chapter II, Paragraph XIII. In May the same year, Uriu Mitsutora, it has to be remembered, translated into Japanese Wheaton's *International Law* directly from the edition of William B. Lawrence.

Woolsey's *International Law* was translated and published by Mitsukuri Rinsho (1846-97) in March, 1873, under the title of 國際法一名万国公法 (Kokusaiho ichimei Bankokukōhō). Mitsukuri will long be remembered as the scholar who proposed the settled Japanese rendering of Kokusaiho for the Law of Nations.

The *Commentary on International Law* by James Kent, (1763-1847), was translated in 1874 by Daion Ryutarō, etc. of the Colonization Department during the Expedition to Formosa, for the convenience of negotiations with

⁸ W. Martin: *A Cycle of Cathay*, 1896, pp. 234, 235. *The Awakening of China*, 1907, pp. 288 et seq. *The Lore of Cathay*, 1901, p. 427.

the Chinese Government. The Elements of International Law by Henry Wager Halleck (1815-72), Major-General of the United States Navy, was translated by Akiyoshi Shogo in 1874 and was published in Tokyo in 1878.

August Wilhelm Heffter (1796-1880) was a professor of Berlin University, whose work on *Das europäische Völkerrecht der Gegenwart auf den bisherigen Grundlagen*, translated jointly by Arakawa Kunizo and Kinoshita Shūichi, was published by the Department of Justice in 1877. Of this book, there was the French version of F. Heinrich Geffcken, but the translation was presumably made directly from the German original.

In the opening years of the nineteenth century, most of the international lawyers were either of the Natural Law school or of the eclectic school more or less closely allied to the former. Wheaton, Ortolan, Woolsey, Halleck, Bluntschli—writers on International Law who were introduced to Japan in translation—while standing on the eclectic grounds, made an affirmation of the Natural Law. Vissering, in particular, adhered to the Natural Law. Wheaton in Martin's translation had this tendency to the Natural Law greatly strengthened; while Kent, Heffter and Martens, though classed as positivists emphasizing the conventions among nations, were not extreme in their assertions, lending their influence by no means to the denial of the Law of Nature. The study of International Law in Japan began from the approach to the Western theories which had the tendencies toward the Natural Law.

III. *The Meiji Restoration and the Law of Nations*

The Meiji Restoration meant at once the downfall of the Tokugawa Shogunate and the renovation of the political regime. The coming of the foreign warships shook the foundations of that Government. The financial difficulties of the Shogunate, poverty of the Samurai class, and agrarian discontent—these phenomena announced the internal collapse of feudal society. The riots occurring in many places of peasants and Ronins and such like events demonstrated the unfitness of the old regime for the new call. The rising influence of money-lenders of Osaka and Sakai heralded the nature of the coming age. Men desired political reforms and economic reconstruction under the authority of the Emperor of Kyoto, by bringing about the downfall of the Shogunate Government of Tokyo. The movement which accelerated this Restoration of the Imperial authority and the reforms was carried through under the banners of the reverence for the Emperor and expulsion of foreigners.

Toward the close of 1867, the Tycoon, Tokugawa Yoshinobu (1837-1913), returned the reins of government to the Emperor of Kyoto. The

New Regime of Meiji which had attained the aim of reverence for the Emperor, was not so foolish as to get perplexed about the policy of expelling foreigners. The party or parties, who carried through the restoration of the Emperor to the seat of authority, tightened liaison with Harry S. Parkes, the British Minister, and sections of the Diplomatic Corps, and New Government, which was still very weak, was rather anxious to obtain the confidence of foreign countries. The New Regime had the need of fiscal revenue and desired the opening of the country, and could not but think of the convenience of donations from the traders. The expulsion of foreigners, which had indeed been intended as tactics to bring down the Shogunate, could not become the policy of the New Regime. The change of tactics was, therefore, found necessary: the open port policy which the Shogunate had adopted with extreme reluctance was now pushed forward with energy. And what was made use of in this change of tactics was the conception of 宇内之公法 (Udai-no-kôho; Public Law of the Universe).

As noted in the preceding Chapter, the Meiji regime was established at a time when, in this country, the idea of the Law of Nations was rapidly spreading. Martin's translation of Wheaton's International Law had been read by the informed groups of the country, who, being Confucianists, were now able to accept the theory of International Law as their own, linked up as it was with the theory of T'ien Tao (天道). The school of Chu-tsu had wanted to see the reason and order of things by the method of 格物窮理 (Kê Wu Ch'üing Li), but now they came to regard the method of modern science, which stood upon the ground of the Natural Law of the Occident, as more exact compared with the attempt of "Investigating things and carrying knowledge to the utmost extent (格物窮理, Kê Wu Ch'üing Li).⁹ The classical theory of Tien Tao was now newly linked up with Occidental civilization, supplying the New Government with a motive power for reforms.

The modern idea of the Natural Law concerns the rule of conduct deriving from the nature of man as a rational being. The Natural Law, which respects as it does the reason and nature of things, is rather inclined to be conservative. When, however, the idealistic aspect of the Natural Law is taken hold of, and this used for the criticism of the existing institutions, it will be seen that it forms an instrument of change and progress. The Natural Law contains within itself elements not merely of naturalism but of idealism, and individualistic idealism, when confronted with feudal absolutism, easily becomes the doctrine of the Enlightenment asserting the laissez-faire. The Chu-tsu school whose teachings had formed for the last three centuries the spiritual basis for Japan as official philosophy of the Shogunate, came to supply the chance for a change from conservatism to

⁹ "Kê wu ch'üing li," a quotation from 大学 Ta hsüe (The Great Learning), was highly prized by the Chu-tsu school as the Golden Rule. James Legge, *the Chinese Classics*, Hongkong, 1861, Vol. 1.

renovationism, after a baptism of the Natural Law of the Occident. The Law of Nations as a term, which the Shogunate officers learned from Harris, rather meant the usage or practice among nations, but on the introduction to Japan of Martin's Chinese translation of Wheaton, a noteworthy change occurred; they came, that is to say, to regard the Law of Nations as the Law of Nature or the Public Law of the Universe itself. The conception of the Law of Nations was turned hereupon into an instrument of renovation as the hands of the New Regime.

In January, 1868, the Meiji Government notified the Ministers of different countries, that it alone was the *de jure* Government representing Japan, making it clear that this Government monopolized the diplomatic authority. On January 15 of the same year, the New Regime issued the proclamation on the opening of the country to foreign intercourse, in which document it was stated that matters of foreign intercourse would be regulated by the public law of the world. At the same time, the presentation at court of the diplomatic representatives was planned: on February 7, 1868, that is, the chiefs of six feudal clans headed by Matsudaira Yoshinaga (Shungaku), 1828-90, jointly memorialized H. I. H. Prince Arisugawa urging the desirability of receiving at court the foreign representatives, the treatment of the Western Powers on an equal footing with China, and the fixation of court institutions and ceremonials, thus supporting the plan of receiving the foreign envoys in audience by the common public laws of nations. Upon this memorial, an edict was issued on February 15 of the same years, and further, on February 17, a proclamation was issued to the effect that this audience would take place in accordance with the common rites of nations. In an accompanying document from the Three Offices of the Dajōkan, this plan was justified by an appeal to the common public laws of nations. The parties, who had advocated the expulsion of foreigners, changed over to the out-right policy of opening the country to foreign intercourse, now that they came to power. This change of policy invited a strong opposition on the part of ultra-nationalists, causing serious anxiety to the New Regime; but here again the common public laws of nations served as a sedative. On February 30, the French and the Netherlands Ministers were received in Kyoto, and on March 3, the British Minister had a similar audience, the foreign Ministers leaving Kyoto on March 4. In this manner, the audiences came off—an unprecedented event which set a new example. In these audiences, the foreign envoys when saluting the Emperor were seen standing. This needs recording for the Japan of these days.

In view of the attempt on the life of British Minister Parkes, the Government issued, March 4, 1868, a declaration for the protection of foreign envoys, prescribing a severe punishment for international law-breakers. It is interesting to note that when, on January 19th same year, the soldiers of

Bizen had injured the Britishers, it was asserted in the council of the Government that the punishment of the culprits be left to the Law of Nations.

In the discussion over the responsibility for the disloyalty of Tokugawa Yoshinobu, the Law of Nations again played a part. In appealing in February, 1868, for the suspension of the plan to send a punitive force against Tokugawa Yoshinobu, the same Matsudaira Yoshinaga remonstrated that it would amount to a violation of public law to call to account an ex-ruler who was now doing penitence in retirement. Before the evacuation of Yedo Castle, it was strongly urged that the castle be entered in good order in conformity with public law.

On the eve of a general attack on Yedo Castle, March 14, 1868, a Program of Five Articles was proclaimed. In the Fourth Article, it was stated that the evils of the past should be done away with and everything be based upon the justice of Heaven and Earth. This settled the national policy of opening the country and prosecution of reform. The author of this Fourth Article was Kido Takayoshi (1833-77), and research has established the fact that Kido stood under the influence of Wheaton's International Law as translated by Uryu Mitsutōra.¹⁰

On January 23, 1868, the Accountant-General issued a notice calling for subscription to a national loan amounting to 3 million Ryo, (silver dollar), promising to redeem the debt contracted at an early opportunity in accordance with the common public laws of nations. At this period, the Law of Nations was very much in fashion; in fact, it was something of an open-sesame.

The Meiji Government, in July, 1872, discontinued the lunar calendar and adopted the solar system. This would accord, it was explained with a good deal of flourish, with the Law of Nations.¹¹

In no country, the Law of Nations, it is submitted, exerted so powerful an influence on the national law as in the period of Meiji renovation. In the early years of Meiji, the Japanese people knew that the Law of Nations possessed a primacy over the national law; but at the same time, it will be seen that in the reception by the Japanese of the Law of Nations, an Oriental adjustment and interpretation were found necessary.

¹⁰ Osatake Takeshi, *the Constitutional Ideas around the Meiji Renovation*, 1925, Tokyo, Chapter 9, Section 2, Paragraph 3.

¹¹ Shimazaki Tōson, *Before the Dawn* (wellknown historical novel in Japan), Part 2, Chapters 2 and 7.

THE INDEPENDENCE OF EXECUTIVE POWER IN RELATION WITH JUDICIAL POWER

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1.

Article 76, paragraph 2 of the new Constitution, different from Article 61 of the old Constitution, has no provisions relating to the administrative tribunals and provides that no extraordinary tribunals should be established nor should any organ or agency of the executive be given final judicial power. This has subjected administrative cases, as well as all civil cases, to judicial review, and, consequently, it seems that the independence of executive power is not recognized, the administrative organs in cases of litigation hold no higher a position than an ordinary citizen. In England in the 17th century, the replacement of the Star Chamber and other special courts by the common law courts, was the result of the oppression of the rights of the people through the political abuse of the former's powers. In France in the 19th century, administrative power's independence of judicial power was secured by the establishment of the extraordinary tribunals on account of the abuse of judicial power through interference in politics by the judicial authorities in the course of the Revolution, and under the influence of the Montesquieu's principle of the mutual independence of the legislature, the executive and the judicature. Thus, it may be said that whether or not the administrative tribunals are maintained depends upon whether the administrative authorities or the judicial authorities enjoy the confidence of the people more; and that the matter is not dependent upon legal thinking. It seems to me rather, that the system of administrative litigation is indispensable if we should carry through the principle of separation of powers. As a matter of fact, in Britain and the United States the system of administrative commission has so developed that its semi-judicial function tends to become more and more independent of the proper judicial power. Under our Constitution the independence of judicial power and administrative power from each other should also be interpreted. Although the problem of to what extent that should be realised is still open to discussion, we can at least say that it would be unconstitutional by reason of violating the principle of separation of powers, if in administrative litigation the administrative organ be given, in negation of its independence, a

place merely equivalent to that of the defendant in civil cases.

As a reaction to the old Constitution, which entailed dictatorship and the oppression of the rights of the people by the bureaucrats, the new Constitution has strengthened the guaranty of fundamental rights and established the decentralization of power by assuring local autonomy. Consequently, distrust of the Executive is often evident in the interpretation of such provisions in the Constitution. Personally, I would not object to taking the interpretation into consideration in legislation, but I do not think we can regard it as consistent with the spirit of the Constitution.

There is a case, for instance, wherein, in accordance with the disciplinary code of employees a certain company discharged an employee who prejudiced the credit of his company and interfered with the management of its business by publishing an organ paper of a cell. This act was claimed to constitute an infringement upon the freedom of the press. On November 20, 1950, the Court of Appeals of Tokyo, however, ruled that Article 21 of the Constitution merely guarantees that no administrative restriction should be imposed upon publication and that Article 21 does not preclude civil and criminal liabilities in connection with the act of publishing. I understand fundamental human rights, in so far as they are incompatible with the public welfare, could be regulated by law to the minimum extent of necessity. In connection with the case mentioned above, this legal principle was accepted by the Supreme Court in the ruling given by all members of the Court on April 4th, 1951. Even the ruling of the High Court of Appeals of Tokyo, in which the court took the position that regulation of human rights for the sake of public welfare was unconstitutional (See Articles 12 and 13 of the Constitution), admits the constitutionality of limiting these rights in accordance with due process of law owing to the grounds that judicial authorities are better qualified to protect human rights than are administrative authorities, for the Administrative power under party government is quite apt to be abused through organs in charge of a single officer as well as the hierarchy of organs, whereas, judicial power, whose function it is to find and declare what the law requires in relation to a specific case, is attended with no such danger. Furthermore, while the Administrative is vested with the power to take preventive measures, at times when jeopardy to public welfare is not always evident and imminent, judicial authorities, as a rule, inquire into the existence of civil or criminal liability after the act has been committed, and thus, in line with the regulation of the Constitution, minimize restrictions upon human rights. In the event of unlawful exercise of administrative power, the sufferer whose human right was infringed thereby has the right to file a *Kōkoku* appeal. But no one can repel effectively such illegal restraint upon his rights by means of this type of appeal since the *Kōkoku* appeal is subject to the principle of preexistence of litigation and by the provisions concerning timelimit for filing

suit. Furthermore, it is a general rule that the effect of an administrative disposition does not cease until a judicial decision nullifying it has become final and conclusive. It is less likely that human rights should be harmed by an illegal judicial decision because it is unexecutable until it has become final.

Restriction upon human rights by the judicial authorities presupposes similar restraints by the legislative body; but it is wholly groundless to say that the formation of civil or criminal laws and regulations affecting human rights is constitutional whereas the enactment of administrative laws and regulations governing those same rights is not. Undoubtedly, the infringement upon human right imposed by prior preventive measures would be more serious than that produced by subsequent corrective actions. However, under circumstances wherein public peace and order are in such a chaotic state that ordinary control would not be contradictory to the Proportion Principle. This principle was endorsed when the Legislative Bureau withdrew its former view that no by-laws for the control of mass marches and mass demonstrations should be deemed constitutional if they required prior authorization over and above notification, and announced that the licence system ought not to be regarded as unconstitutional *ipso facto*.

Lack of confidence in administrative power and respect for judicial power are manifest in the Local Autonomy Law which does not recognize administrative supervision of local subdivisions by the Government but rather allows the Mandamus suit with respect to the Government's control over affairs directly entrusted to the heads of such local subdivisions. This law contains instructions as to the standard of the auxiliary organs and the increase of efficiency of service. It is not fully justifiable to say that such control over local autonomy in the form of legislation is constitutional while like control by the administrative authorities constitutes a violation of the principle of local self-government. It is true the term "control" in the Local Autonomy Law was deleted when the law was amended last year, but that did not alter the fundamental relation between the Government and the local subdivisions. In my interpretation, however, it is not unconstitutional that administrative authorities are empowered to watch the legality of the action of the local subdivisions. It appears that a subsequent redress of an illegal act of local administration can be attained only through judicial channels, but the only resort actually available is administrative control since no one is in general permitted to file a suit until the occurrence of actual infringement upon one's rights. It is for the Legislative to decide to what extent control by the Administration over local autonomy should be exercised.

2.

By providing that the rights of the people should be supremely respected,

Article 13 of the Constitution has guaranteed the sufferer whose right has been violated by an illegal administrative disposition the right to sue for the annulment of the disposition. It is, however, highly questionable whether the sufferer from an illegal act of the Administration is entitled to request an execution against the State. I understand that the execution against public property would in all probability not be permitted. Moreover, no execution, in my opinion, is allowable in administrative cases since there is little need for it, the administrative organs being bound to abide by the final judgment in administrative cases in accordance with Article 12 of the Special Rule *infra*.

However, if the people were not allowed to institute action for the annulment of an illegal disposition, it would imply that the rights of the people were not being given supreme consideration. In respect to subjective judgment which stands for relieving rights violated, under Article 3 of the Court Organization Law all the legal disputes are brought within the jurisdiction of the Court is proper and right. But if it were generally possible to bring objective action such as an inter-organ action and a people's action, the Court would go beyond the proper scope of its judicial power and transgress the power of administration, thus running counter to the principle of separation of powers as provided in the Constitution. Inter-organ action is concerned with legal disputes between executive organs. Thus, an action of the Assembly for annulment of the dissolution of a local assembly in contravention of the chief executive officer of the local political subdivision, is an inter-organ action, but is not legitimate because of the lack of provisions permitting the bringing of such an action (cf. Decision of the Matsuyama District Court, March 16, 1950). On the other hand, an action instituted by a member of an Assembly for declaration of nullity of the dissolution of that Assembly on the ground of nullity of the non-confidence resolution is admissible since it seeks to safeguard the right to participate as a member of an Assembly in the government (Decision of the Matsuyama District Court, April 20, 1950). Next, the people's action is one which can be brought by the electors or the people at large in order to rectify illegal administration. Article 243-(2) of the Local Autonomy Law provided for the restriction or prohibition of illegal acts of executive personnel or the annulment or rescission of illegal acts. However, an action for the retirement of a prefectural governor or for the dismissal of executive personnel is inadmissible, since it is a people's action not supported with legal provisions (Yokohama District Court, May 29, 1950).

3.

In case the administrative organs are allowed to act with discretion, an unreasonable administrative disposition caused by a wrong exercise of discretion, will not be illegal; it could be deemed only as an improper disposi-

tion from a political or technical viewpoint. Where discretion is permitted, the administration is free from law. Therefore, in performing a specific administrative act, it is required, first, that no law is as yet enacted to govern it; second, that the administrative action can be effected without specific law. Whereas Article 31 of the Constitution provides that "No person shall be deprived of...liberty..., except according to procedure established by law." It follows, as a matter of course, that the administrative action which has the effect of infringing upon the rights of the people or subjecting them to obligations must always be based on law and be subject to *Ermessen der Rechtmässigkeit* or a legal discretion. An administrative disposition which simply gives rights or benefits to the people and inter-organ action may be considered to come under the discretion of each administrative office. But, in this case as well, there are relevant provisions of law to govern the rights to be granted. In addition, there is a certain law pertaining to the administrative organization. Thus, it is hardly possible to admit administrative discretion in fields not covered by law.

The peculiarity of discretionary disposition is marked by the fact that any act of the administrative office, even if misguided by discretion, is not subject to judicial review. Even where administrative action is governed by law, discretion is recognized within that area of independence of the executive power which is beyond the control of the judicial power. We have a striking instance of this in the case of *besonderes Gewaltverhältnis*, for performance of duty, disciplinary punishment, etc. of Government employees presuppose the contract of obedience under public law, and the administrative office may, in so far as it exercises special comprehensive power on the basis of the voluntary consent of the opponent, direct and compel the latter, while the opponent can be considered as having waived, to that extent, its right to bring action. Unquestionably, it would be a mistake to regard that the guarantee of civil rights may be removed freely by the voluntary assent of the opponent of the administrative office. However, discretion of the administrative office may be allowed to the extent that it does not interfere with public welfare, and so long as it does not deprive the rights and benefits, contrary to *besonderes Gewaltverhältnis* under which may exist deprivation of such rights and benefits.

As regards disciplinary punishment, discretion is permitted except where the extraordinary power relationship, the very ground on which the punishment can be imposed, is established compulsorily by law, where the reason for the punishment is clearly against laws pertaining to the extraordinary power relationship, and where the effects of the punishment attended with the infringement upon a right or liberty under the general relationship of government, exceed the extent of deprivation of rights and benefits, a deprivation which is natural within the extraordinary power relationship.

With reference to the case of suspension of execution of resolution for

the expulsion of members of the Aomori Prefectural Assembly, the Supreme Court dismissed by a ruling the extraordinary complaint (January 16, 1953). This ruling supports the original one, which regarded the objection as null and void, on the grounds that under Article 10 of the Special Regulations concerning the Procedure for Administrative Litigations, an objection of the Prime Minister must be made prior to the suspension of execution of an administrative disposition. Expressing the minority opinion in the above ruling, Chief Justice Tanaka stated that an expulsion of members is a question of discipline within the Assembly, an organ which lies outside of the scope of intervention by judicial power, and, thus should properly be left to the decision of the Assembly. According to this opinion, the court can not interfere with the propriety of a discretionary disposition of the administrative office. Nor can the court interfere with the discretionary disposition even where the issue is subject to the provisions of laws, if the fulfilment or non-fulfilment of the requirements of laws is entirely left to the independent decision of the community concerned. The expulsion of Assembly members is asserted to come under the latter case. However, this distinction is not always sufficiently clear, and in the opinion of the same judge it is held that disciplinary punishment improperly imposed is reduced, after all, to the question of fact-finding or discretion and that accordingly the question of propriety of the disposition is only matter of politics, and not that of illegality. Further, in the opinion of Mr. Kuriyama, Judge of the same Court, it is held that a local assembly has, like the two Houses of the Diet, proper power to determine the rules of procedure and to impose disciplinary punishment upon its members; that the assembly adheres to the independence of its operation of proceedings, against interference from outside; and that its decision on expulsion should be final and conclusive. These minority opinions admit the independency of a local assembly and also a certain area, including disciplinary punishment, which is beyond the scope of judicial review. Against these views, Mr. Mano, Judge of the same Court, says that disciplinary punishment, in so far as it remains within the scope of discretion, may not raise the question of illegality, but that its non-compliance with the standards of law will, because of its illegality, make it a question of law even where it is actually a question of politics. Thus he upholds the manner of thinking hitherto assumed in judicial precedents, that there may exist illegal discretionary dispositions.

With reference to the case concerning the application for annulment of expulsion of several public high school students, the Okayama District Court rejected the refutation of the defendant. The defendant had asserted that disciplinary punishment was a disposition leaving very much toward the technical phase of education, that it was not, essentially, an act very closely associated with judgment, and that it might give rise only to the question of propriety. The Court based its argument on the grounds that

the illegality of the disposition may have been a subject of dispute, if it is possible to contend that the disposition did not clarify the reasons for expulsion as prescribed in the school regulations; that it was a disposition remarkably unfair and severe, quite in excess of the power of discretion vested in the administrative office which made the disposition; that it was made together with domiciliary confinement (Judgment, May 30, 1951). However, this judgment was reversed by that of the Okayama Branch of the Hiroshima Higher Court. The gist of the latter judgment is that, since disciplinary punishment is imposed upon students for the attainment of the desired end of education, its propriety should come under review, first of all, out of consideration of the technical share of education; and that disciplinary punishment should not properly be subjected to the judgment of the Court so far as its respect to propriety is concerned; but that it cannot be annulled unless the disposition was so extreme and so unjustifiable that it could not be tolerated under the social structure (Judgment, July 18, 1952). This apparently coincides with the contention of the defendant at the first trial. However, referring to the minority opinion of Chief Justice Tanaka, see above, wherein he drew a parallel between local assemblies and schools, it was held that, if the disposition of expulsion from school, made with respect to university students, was deemed, like penalties such as reprimand and suspension from school, to be governed by the internal rules of a school, there would be no reasonable grounds on which to distinguish between dismissal from Assembly membership and other kinds of penalties; and that accordingly disciplinary punishment in the case of universities and that in the case of Assembly might be considered to have something in common. Whereas, in the judgment rendered by the Hiroshima Higher Court, it is pointed out that disciplinary punishment in the case of students is distinct from that in the case of component members of an organization, because the former is designed for educational purposes and the latter merely for maintenance of order within the organization.

According to pertinent judicial precedent, it is held that, where excessive exercise of discretion is in dispute, it should be subjected to lawful judicial review and in the event the disposition at issue is deemed not illegal, the application for suit should be dismissed (Judgment of Tokyo District Court, January 14, 1950). Under the former Constitution where only a very few matters could have access to administrative litigations, there were only small number of dispositions which could be made the subject of lawsuit, even though they were found illegal in terms of substantive law. This seems also the case with respect to disposition whereof one failed to observe the term of bringing an action, for such disposition may not necessarily be legal. Further, although distinction was made conceptually between dispositions coming under subjects of litigations and those made by discretion, little practical use resulted therefrom. Consequently, it was without doubt

that an action brought in respect of a discretionary disposition was usually to be dismissed. Under the new Constitution, however, subjects of litigation are not restricted to either administrative cases or to civil cases. Therefore with respect to illegal dispositions, it has become generally possible to apply for annulment. Further, it can be considered that the recognition that a disposition is the result of discretion has the same meaning as a declaration of its legality, and that accordingly in such cases the judgment rendered has resulted in the judicial precedent of the dismissal of application. However, the recognition of the fact that the scope of discretion belonging properly to administrative office, only means directly that judicial review is excluded but that from the viewpoint of Substantive Law, a discretionary disposition is not always lawful. Therefore, in case it is clear that the disposition in respect of the issue in dispute comes under the subject of discretion a ruling for dismissal should properly be passed, and it will be incorrect to reject the application.

- 4.

The Law for Special Regulations concerning the Procedure for Administrative Litigations specifies the term for bringing an action (Art. 5). It also provides that the bringing of an action will not suspend the execution of the administrative disposition in dispute (Art. 10). It has similar provisions with respect to the procedure regarding application for judgment of an administrative office, such as *Sogan* appeal and filing of objection. In case the agency which made the disposition finds the disposition illegal, it should annul such dispositions ex-officio even after the lapse of the term for institution of action. Further, a public official will be answerable for his civil as well as criminal liability resulting from abuse of official power. However, insofar as the agency which made the disposition insists on the legality of its disposition, that disposition is executable even when its opponent insists on its illegality, and the disposition becomes indisputable because of the failure to observe the term for bringing action. The basis for this outcome is that it has become possible to presume from a legalistic viewpoint the legality of the disposition. In this connection, Kelsen asserts that such a presumption of legality is impossible from the 'law-logical' viewpoint, for it implies the political principle of giving prominence to the executive power. However, even in the theory of Otto Mayer which admits the presumption of legality, it is held that a disposition which is clearly and seriously illegal is necessarily inoperative even before it is annulled. The theory admits only that, where the legality of the disposition is in dispute, the assertion of the administrative office is regarded as reasonable, unless otherwise warranted by adequate counter-evidence. Accordingly, Kelsen's theory is not acceptable except in cases wherein the illegality of the disposition is not in dispute between the parties concerned or wherein the judgment of the office

which made the disposition is held to be of equal value to the contention of a private individual who is its opponent.

In civil cases, and as the effects of Court action, both the formal and the substantial binding forces are produced simultaneously; whereas, in the case of administrative disposition an action applying for annulment thereof will be dismissed through failure to observe the term for bringing action. It may be considered that here the formal binding force is produced by the administrative disposition, just as judgment in the first instance becomes incontestable through failure to observe the term of appeal after that judgment is rendered. But in this case no court action has been taken; consequently, no substantial binding force will be produced, and the administrative office may therefore rescind the disposition. Further, an administrative disposition resembles a final and conclusive judgment in the sense that in the former the execution of the disposition in dispute may not be suspended by means of the institution of an action applying for its annulment, as distinct from that of the judgment in the first instance which may be suspended by the filing of an appeal. Non-suspension of the execution of an administrative disposition implies that the disposition will not be prevented from taking effect and also that all subsequent procedures and the execution based thereon will not be suspended. Accordingly, a police disposition, if it is not *ipso facto* null and void, but may be illegal, may bind any person who does not comply with it. Resistance thereto will constitute an offense of the use of violence against a public official in the performance of his duties. The plaintiff in a suit for the annulment of an illegal disposition can apply for a suspension of execution of the disposition in dispute (Art. 10, Special Regulations concerning the Procedure for Administrative Litigations). This case, however, is an extraordinary instance of a provisional disposition wherein administrative function is performed by the judicial power, and consequently various restrictions are here imposed with regard to such dispositions. When the Prime Minister in particular raises an objection as regarding the suspension of an execution, the Court cannot render a ruling of suspension thereof. Nor can the court render ruling when the damage may be compensated good by payment of money, as in the case of damage due to the execution of disposition against tax default (Judgment, Tokushima District, May 30, 1950).

It would appear that a plaintiff applying for annulment of an illegal disposition is in an offensive position, but actually he is in a defensive position. Therefore, according to the principle of distribution of burden of proof in the Code of Civil Procedure under which the burden of proof is on the person affirming the existence of a certain legal effect, the burden of proof as regards legality of the disposition in dispute must be on the administrative office which made the disposition. However, this will only put a disposition which has become irrevocable through failure to observe

the term for bringing an action, extremely out of proportion to the disposition to be disputed by action. Furthermore, the institution of action concerning the determination of its will will transfer discretion which is proper to the administrative office to the judicial power, which in turn will undertake to make an administrative disposition. Consequently, it may be proper to hold that under the Special Regulations concerning the Procedure for Administrative Litigations the legality of administrative dispositions is by law presumed, and therefore, with respect to the illegality of the disposition in dispute, the burden of proof will be upon the plaintiff. The National Tax Collection Law (Art. 31 (4)) provides that, if the Court finds the contention of the administrative office, as defendant, reasonable, the plaintiff should be directed to produce counter-evidence. This may be regarded as a compromise of the opinion of the Finance Ministry which places the burden of proof upon the plaintiff and that of the Court which placed it upon the defendant. However this compromise is not a final solution of the problem.

- 5.

The administrative action which imposes a new duty on the people or violates any of the rights of the people, is required, under Article 31 of the Constitution, to be based upon law. Therefore, even wherein the law, from which authority is derived, admits the discretion of the administrative office, the exercise of the right of discretion will, as a question of law, be subject to full-scale criticism and also to judicial review. A mistake in such discretion will make the administrative disposition illegal and subject it to the review of the Court, such error being ground for annulment. However, a disposition will be fixed primarily by the free discretion of the administrative office and the legality of the disposition presumed unless counter-evidence is produced in subsequent action. Therefore, the opponent may have no other recourse than to sue for annulment or for declaration of nullity thereof after disposition has been made. *Leistungsurteil* or 'performance' judgment, which directs, prior to the making of disposition, the effectuation or non-effectuation of the disposition, and *Gestaltungsurteil* or 'formative' judgment, which causes, on behalf of the disposing agency, the same effect as may be produced when the disposition has been made, will both become binding upon the discretion of the administrative office, by virtue of the binding force of the judgment, thus running counter to the principle of separation of powers. As compared with formative judgment, performance judgment to a limited extent infringes upon the freedom of choice of the administrative office. However, if the executability of performance judgment were admitted, the Court would exercise supervision similar to that of a superior agency over the administrative office, an authority which runs counter to the principle of separation of powers.

The declaratory judgment as to whether the administrative office is

obliged or not authorized to make a specific disposition is not incompatible with the principle of separation of powers, but it is doubtful to assume that the plaintiff may derive the benefit of protection of rights through application for a non-executory judgment.

An "action applying for annulment or alteration of illegal disposition" under Article 1 of the Special Regulations concerning the Procedure for Administrative Litigations should, therefore, properly be construed to mean an action applying for annulment, in whole or in part, of the disposition in dispute. Actions for different disposition than that of the original disposition are not properly included in actions applying for alteration of the disposition.

Further, the judgment of annulment of an illegal disposition produces the effects of annulment by virtue of the provisions (Art. 12 of the Special Regulations concerning the Procedure for Administrative Litigations) under which the establishment of illegality of the disposition by the judicial power becomes binding upon the administrative office concerned. On the other hand, the annulment effected ex-officio by the administrative office is not necessarily limited, as distinct from the former judgment, to cases of illegality of dispositions, but forms, as often as not, a second disposition, the substance of which is the reverse of the original one. For the judicial administration is the operation of reasoning which, with reference to concrete cases where civil rights are in dispute, interprets law as the major premise, finds facts as the minor premise and lastly draws a final and conclusive judgment. In this sense, actions applying for annulment may be regarded as those applying for declaration of illegality as ground for annulment.

A NOTE ON "LONG TERM CHANGES IN THE NATIONAL PRODUCT OF JAPAN"

By KAZUSHI OHKAWA

ERRATA

(I) Table X, Total(A) (II) Table XI, National Income

Incorrect	Correct
3.7	4.2
5.0	4.9
5.4	5.4
2.6	3.0
2.0	3.0
3.0	3.5
3.3	4.1
3.1	5.1
3.5	5.5
3.2	4.7
5.7	3.8

Incorrect		Correct	
(I)	(II)	(I)	(II)
2.3	2.5	2.8	3.0
3.8	3.9	3.7	3.8
4.5	4.4	4.5	4.4
1.9	1.4	2.3	1.8
1.5	0.7	2.5	1.7
2.6	1.6	3.1	2.1
2.9	2.0	3.7	2.8
2.4	1.9	4.4	3.9
2.7	2.1	4.7	4.1
2.4	1.7	3.9	3.2
4.7	4.7	2.8	2.8

(III)

Page	Line	Incorrect	Correct
176	8	between 2.0 and 5.7	between 3.0 and 5.4
„	9~10	varies slightly at over 3.0	lies between 3.5 and 5.5
„	10~13	except the...period	eliminate phrases

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